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JOURNAL OF ACCOUNTANCY

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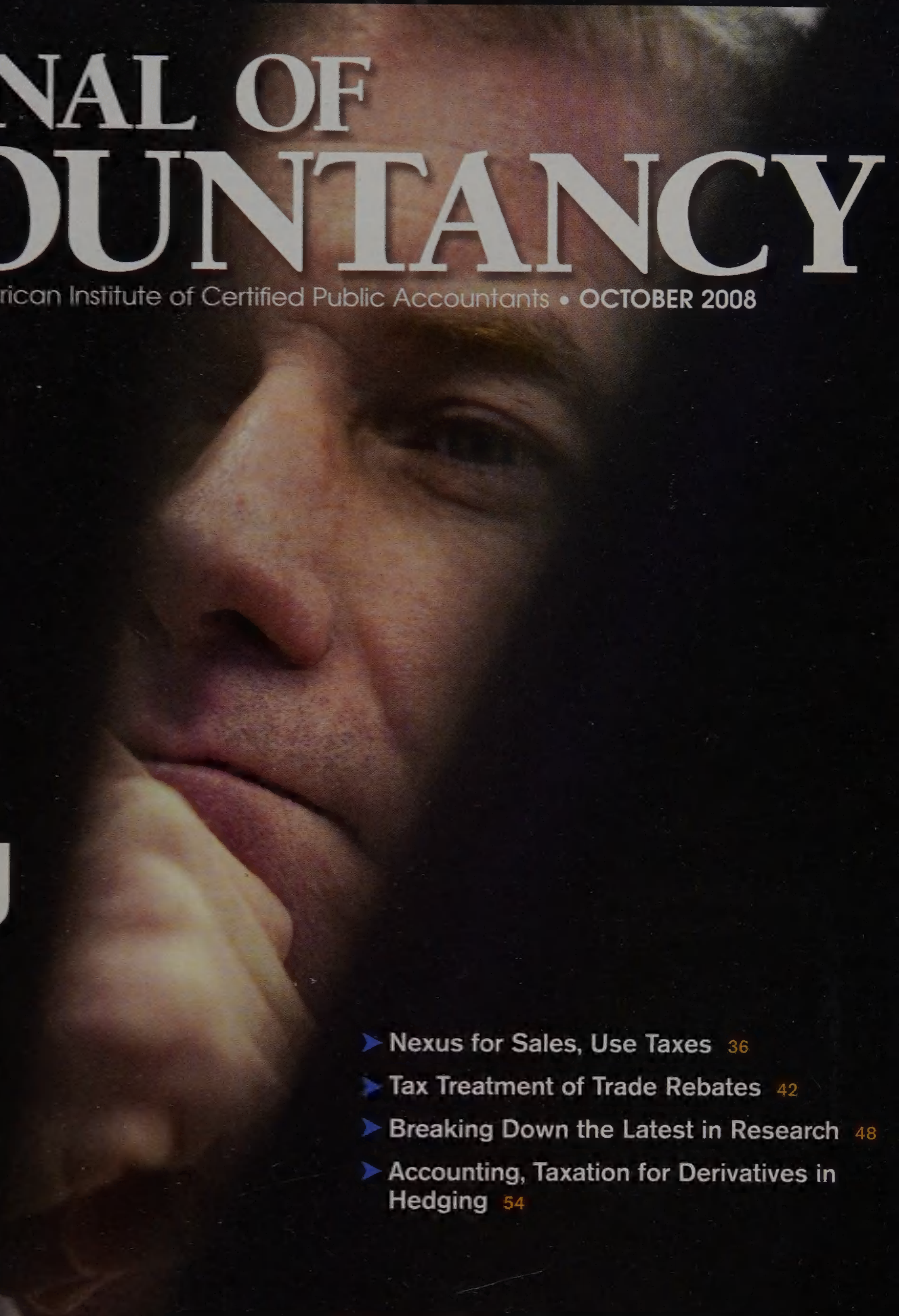

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Changing Perceptions of Client Payroll

CPAs Find Payroll can be Easy

Many CPAs do client payroll, but somewhat reluctantly. For a large number of CPAs, it is only after requests from clients that they consider doing their payroll. After all, accountants do not wish to disappoint their loyal customers. CPAs, therefore, often take on payroll to maintain client relationships- even if they feel trepidation in doing so because payroll is not their specialty. It is no surprise that for many CPAs, the perception of client payroll is that it is time consuming, difficult, and not profitable.

Online payroll services, however, are changing perceptions of client payroll. Chores such as paying federal and state payroll tax liabilities and mailing forms can now be done electronically. In a few mouse clicks, a CPA or his assistant can send in their clients' payroll taxes and tax forms. These are tasks that staff used to dread but which are now very simple.

Online Payroll Simplifies Tasks

Another payroll task that CPAs find burdensome is collecting payday information for clients every pay period. To do this, someone had to be available to receive the client's information for the hours worked for each employee. Online payroll services through PayCycle have eliminated such burdens. CPAs can grant their clients access to the web-based service- branded with the CPA's name- so that clients can enter payday information themselves. CPAs can even set 'client permission levels' to give clients the ability to run payroll only, or to run payroll and setup employees, or to do all tasks including paying taxes and filing forms.

With technology making payroll easier and more profitable, CPAs are finding value in payroll which they may not have expected. Many CPAs are even accepting more payroll clients since payroll can be done so quickly and easily by the CPA or by the clients themselves.

PayCycle Makes Payroll Profitable and Easy

PayCycle's Accounting Professional Program is a monthly "pay as you go" program–with no commitments–designed to make client payroll easy and profitable. And you don't have to become a payroll expert to use the program. In fact, 37% of accounting professionals using PayCycle had never done client payroll prior to using the service.

PayCycle's online solution walks you through the entire payroll process from paychecks to W-2s. The service integrates with most leading accounting programs including QuickBooks® and Peachtree®. In addition, PayCycle leads all online and software-based payroll services with the most complete electronic federal and state payment and filing coverage.

Priced for Firm Profit

Thousands of CPAs have discovered that PayCycle makes client payroll easier and more automated than ever before. With a base price of $14.99 per client per month, PayCycle leaves significant room for profit. A PayCycle study shows that accountants typically earn 50% profit from payroll using PayCycle and spend just minutes every month on payroll tasks. CPAs, however, often earn profit margins of 70% or higher. By offering payroll services, CPAs can build stronger, longer lasting client relationships while earning income year round.

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PayCycle is Easier to Use for My Clients' Payroll than QuickBooks®

By Jody Padar, CPA, MST

I started my career at Price Waterhouse and then went on to work for a couple of small-to-mid size accounting firms in Chicago. I was at these firms gaining experience with the expectation of taking over my father's firm, James J. Matousek, CPA, Ltd. Yet most of my dad's practice included working with individuals not small businesses. However, I knew that if we were going to be in business together, that we needed to work with corporate clients. And those clients need payroll.

Jody Padar, CPA, MST
Mount Prospect, IL
PayCycle User Since 2006

Jody is an adjunct professor at Oakton Community College, where she teaches QuickBooks and Income Tax courses.

Client Payroll was Tedious

My association with client payroll was a "payroll bucket". At a firm where I worked 12 years ago, we literally had a bucket where we dumped all clients' payroll information. At the end of every month, each associate had to pick some companies' files out of the bucket and do their payroll tax returns. I hated month-end and that bucket. We did payroll on pink graph paper.

When I started with my father's firm in 2006, people started asking us about payroll. At first, I was using QuickBooks to do client payroll. But that was too much work. It would take me an hour to prepare and transfer the payroll file to the client. But I couldn't bill $100 for that. Then I had to worry about their forms. They had to sign the forms, and I had to get them their coupon so that they could pay their tax deposits- just too much work. So I went looking for another method.

Online Payroll was Much Easier

In 2006, I saw a demo of PayCycle at a tradeshow in Chicago. I thought that it looked really easy. I started using it for our own firm's payroll and realized how simple it was to use. I could take care of all of our federal and state tax payments and forms electronically. That was great. I began using PayCycle for my clients. I like how direct deposit and electronic services are included in the price. Intuit® charges for that.

We do a lot of tax work at James J. Matousek, CPA, Ltd. I have a Masters in Taxation and my father has a lot of experience. But taxes are seasonal. I wanted a way to average out our income stream, not just relying on May and June. Payroll provides that, plus it leads to more corporate accounting billing services.

An Easy Way to Generate Income

I estimate I make a 60% return from payroll. I hired a stay at home mom, who is a teacher by trade, to do it. Training her took very little time because PayCycle is so easy. Some of my clients do their payroll themselves using PayCycle. I give them access to a website branded with my firm name that PayCycle provides. My clients are completely comfortable doing their own payroll when I give them access.

PayCycle has been great. I was even able to run payroll from my web-enabled cell phone once when I was in a pinch. Not that I make a habit out of doing payroll on my phone. But it's good to know that payroll can be so easy and flexible with the right service.

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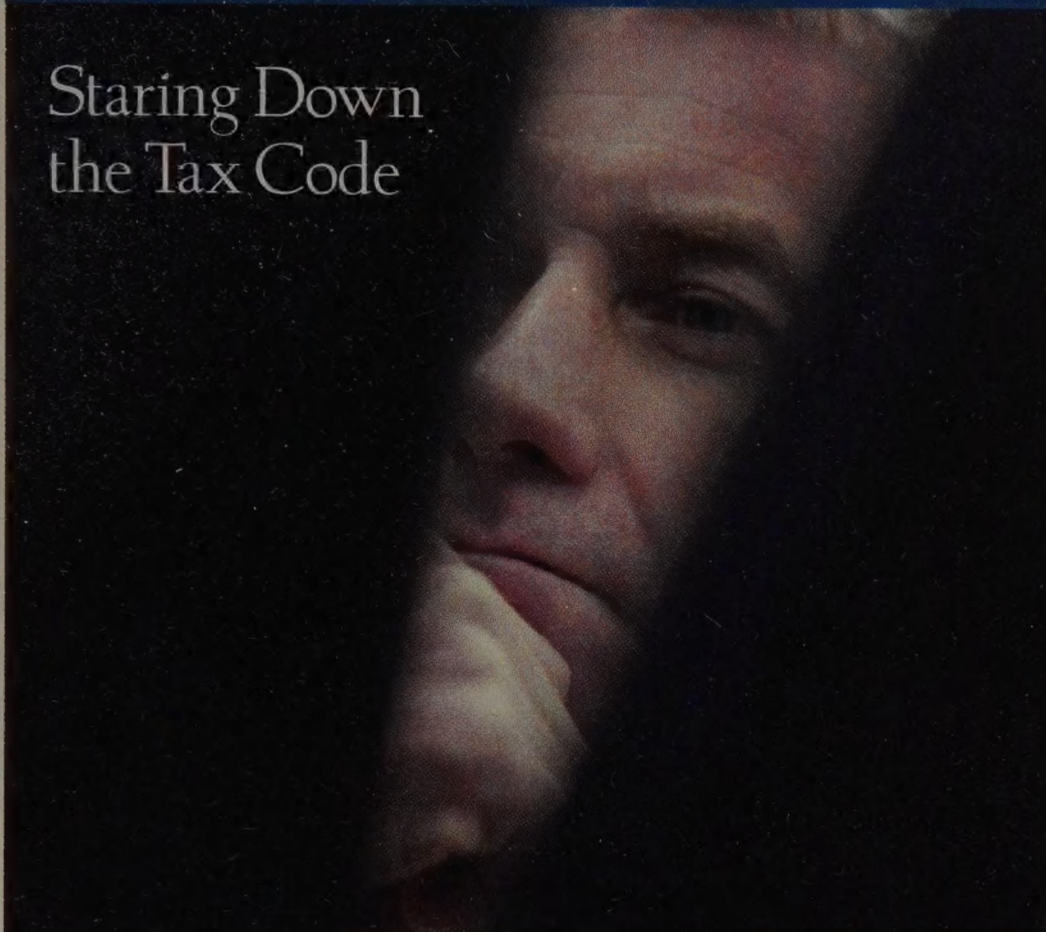

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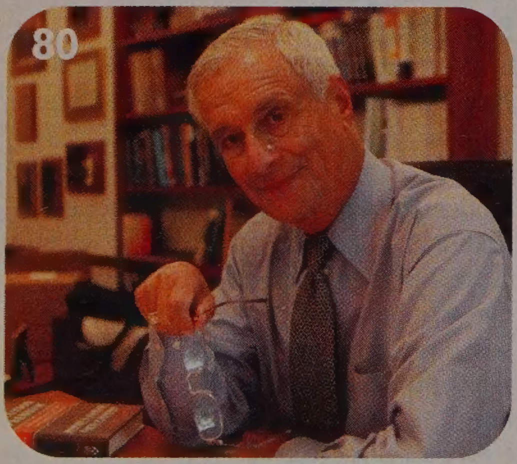

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IN THIS ISSUE

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Publisher and Editor-in-Chief
Joanne E. Fiore (jfiore@aicpa.org)

Managing Editor
Rocky S. Rosen (rrosen@aicpa.org)

Senior Editors
Paul Bonner (pbonner@aicpa.org)
Matthew G. Lamoreaux (mlamoreaux@aicpa.org)
Kim Nilsen (knilsen@aicpa.org)
Loanna Overcash (lovercash@aicpa.org)

Senior Assistant Editor
Amelia Rasmus (arasmus@aicpa.org)

Assistant Editor
Megan Pinkston (mpinkston@aicpa.org)

Copy Editors
Todd Conard (tconard@aicpa.org)
Jeffrey Gilman (jgilman@aicpa.org)

Contributing Editors
Alistair M. Nevius (anevius@aicpa.org)
Stanley Zarowin (stanley.joatech@gmail.com)

Administrative Assistant
Christine Sposito (csposito@aicpa.org)

Art Director
Michael Schad Johnstone (mjohnstone@aicpa.org)

Publishing Coordinator
Geoffrey L. Pickard (gpickard@aicpa.org)

Associate Publisher
Karin DeMarco (kdemarco@aicpa.org)

Advertising Representatives
Joanne Bailey (jbailey@aicpa.org)
Paul Hayes (phayes@aicpa.org)
Collene Toth (ctoth@aicpa.org)

Advertising Production Manager
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■ **Tax Treatment of Rebates May Be Clearing Up** page 42

Larry Maples, CPA (inactive), DBA, is a professor of accounting at Tennessee State University in Nashville, Tenn. He is the author of "Tax Accounting for Long-Term Contracts" in CCH's Federal Tax Service. He has published more than 90 articles in professional journals including the *Journal of Accountancy*, the *Journal of Taxation*, *The Tax Adviser* and others. He has received awards for teaching and research and in 2002 was named a Prolific Author of Accounting Literature in a study of the top 40 accounting-related journals.

■ **A Showcase of Tax Research** page 48

Cynthia Bolt-Lee, CPA, M. Taxation, is an associate professor at The Citadel School of Business Administration in Charleston, S.C., where she teaches taxation, auditing and introductory accounting. She has worked eight years in tax and audit practice for international and local firms. Her research interests include tax ethics, accounting education, practitioners' use of research, and innovative instructional strategies.

Elizabeth Plummer, CPA, Ph.D., is an associate professor of accounting at the Neeley School of Business at Texas Christian University in Fort Worth, Texas, where she teaches taxation. Her research interests include taxation and public finance. Prior to entering academics, she worked at Price Waterhouse (now PricewaterhouseCoopers).

■ **Derivatives and Hedging: Accounting vs. Taxation** page 54

Robert Bloom, Ph.D., is a professor of accountancy at John Carroll University in University Heights, Ohio. He has published nine books and dozens of articles including previously in the *Journal of Accountancy* "Tax Matters" case studies in 2003, 2004 and 2008.

William J. Cenker, CPA, Ph.D., who died March 21 at age 54, was a professor of accountancy at John Carroll University and a practicing CPA and consultant. He was a member of the AICPA and had published many articles, including co-authoring with Robert Bloom two "Tax Matters" case studies in the *Journal of Accountancy.*

■ **XBRL Around the World** page 62

Karen Kernan is an author and communications consultant who, for the past three years, has been following XBRL developments in the U.S. and around the world. She began her career as a journalist and held various positions with marketing and e-learning companies in Connecticut working directly with *Fortune* 1000 clients, before establishing her consulting practice, Writing For Business LLC, which specializes in finance, technology, and executive communications.

■ **Better Brainstorming** page 70

Mark Landis, Ph.D., is an assistant professor of accounting at San Francisco State University. His areas of expertise include information systems, group decision making and auditor decision making.

Scott I. Jerris, Ph.D., is a professor of accounting at San Francisco State University. His areas of expertise are capital markets and financial statement analysis.

Mike Braswell, Ph.D., is an assistant professor of accounting at San Francisco State University. His areas of expertise include corporate governance and financial statement quality.

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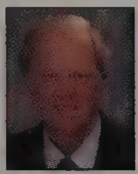
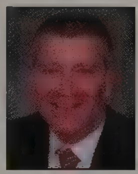
■ **Refocusing on Reliability** page 74

F. Todd DeZoort, Ph.D., is professor of accounting and accounting advisory board fellow in the Culverhouse School of Accountancy at The University of Alabama. He is a member of the AICPA's Reliability Task Force.



David K. Morgan, CPA, is the co-managing partner of Lattimore Black Morgan & Cain PC in Nashville, Tenn. He heads the firm's family office practice, where he works with high-net-worth individuals and family-owned businesses. He is chairman of the executive committee of the AICPA's Private Companies Practice Section and was chairman of the AICPA Reliability Task Force.



Thomas A. Ratcliffe, CPA, Ph.D., is director of accounting and auditing at Wilson Price in Montgomery, Ala., and director emeritus of the School of Accountancy at Troy University. He is chair of the AICPA's Accounting and Review Services Committee.

Mark H. Taylor, CPA, Ph.D., is professor of accounting and John P. Begley endowed chair in accounting in the College of Business Administration at Creighton University in Omaha, Neb. He is a member of two AICPA task forces: the Reliability Task Force and the Auditor's Report Research Task Force.

HIGHLIGHTS

FASB issued a revised exposure draft of a Proposed Statement of Financial Accounting Standards, *Earnings per Share—an amendment of FASB Statement No. 128.* The proposed statement is intended to improve financial reporting by clarifying and simplifying the method of calculating earnings per share.

As part of international convergence efforts, the proposal seeks to eliminate major differences between FASB Statement no. 128, *Earnings per Share*, and International Accounting Standard no. 33, *Earnings per Share*. Proposed amendments to IAS 33 were issued separately by the IASB.

FASB's proposal would improve comparability of EPS because the denominator used to compute EPS under Statement no. 128 would be the same as the denominator used to compute EPS under IAS 33, with limited exceptions. Those exceptions relate to certain instruments for which the underlying accounting under U.S. GAAP and IFRS differs.

The draft, available at **www.fasb.org/draft/rev_ed_eps_amend_st128.pdf**, seeks feedback from constituents by Dec. 5 on whether the proposed statement achieves FASB's goals. The ED does not include a specific effective date for a final statement. FASB will determine the effective date when it approves the final amendments to Statement no. 128.

The AICPA launched a daily electronic publication, *CPA Letter Daily*, which is delivered via e-mail and available only on an opt-in basis.

Each daily newsletter brings:

- Links to important breaking stories, culled from hundreds of top news sources.
- Summaries of relevant research and articles.
- Wireless functionality for mobile readers.
- The latest information from the AICPA.

All news stories provide links to the original source material, often multiple sources. Videos, analysis and interactive components also are featured. Links to AICPA and accounting-related Web sites are included in each issue as well.

The AICPA began this daily news service in response to members. A recent *CPA Letter* readership survey showed 80% of respondents would support a digitally based newsletter so they can get breaking news, updated articles and links to additional resources.

Sign up to receive *CPA Letter Daily* by following the link at **www.aicpa.org**. The link, a Web-based interactive tool, also features the day's news items for *CPA Letter Daily*, and gives readers quick and easy access to the day's news when placed on their personal Web sites or blogs using a simple "Grab This" function.

Or, e-mail cpaletter@aicpa.org to receive an issue of *CPA Letter Daily*, which provides a sign-up option. E-mail addresses and personal information can only be used by the AICPA, and readers can opt out at any time.

The *CPA Letter Daily* is produced in partnership with SmartBrief Inc. The company provides e-news briefs to more than 76 associations and companies, distributing about 1.6 million e-newsletters daily.

The AICPA's Private Companies Practice Section launched the PCPS Succession Resource Center. The Center offers resources for practitioners who want to sell or merge a firm, develop future leaders, handle retirement transitions, or wind down a firm at retirement.

The Succession Institute provides source material for the Center. AICPA members have access to the *PCPS 2008 Succession Survey Research Report*, which tracks how the profession is handling the transition to new ownership or leadership, as a free preview into the PCPS Succession Resource Center.

The PCPS Human Capital Center also was updated. The "Strategy and Planning" section contains new videos that PCPS members can use to implement steps in the section's Strategic Planning Guide. The Generation/Diversity Integration section added documents to help practitioners address the needs and expectations of younger staff members.

To access the PCPS Succession Center and related resources, go to the PCPS Firm Practice Center at **http://pcps.aicpa.org**.

FASB issued FASB Staff Position FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds.*

"The FSP addresses issues that are very important to the not-for-profit sector, especially organizations with sizable endowments and the users of their financial statements, such as donors, credit rating agencies, and regulators," Jeffrey Mechanick, FASB project manager, said in a press release. "Organizations across the country now find themselves subject to increased public scrutiny on how they manage and use their endowments, which in many instances have seen tremendous growth over the past decade."

The FSP provides guidance on classifying the net assets (equity) associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006, which serves as a model act for states to modernize their laws governing donor-restricted endowment funds.

Approximately 20 states have already done so, and more are expected to follow suit over the next few years. The FSP also requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations.

The FSP is available at **www.fasb.org/pdf/fsp_fas117-1.pdf**. The provisions are effective for fiscal years ending after Dec. 15, 2008. Early application is permitted if the organization has not previously issued annual financial statements for that fiscal year.

■ **The SEC launched a Web-based research guide to assist mutual funds in their anti-money laundering (AML) compliance efforts and installed a phone line for securities firms to report the filing of a Suspicious Activity Report (SAR) that may require immediate attention by the SEC.**

The research guide, named the AML Source Tool for Mutual Funds, provides links to key AML laws, rules and related guidance to help mutual funds maintain their AML compliance programs as required by law. It is available on the SEC Web site at **www.sec.gov/about/offices/ocie/amlmfsourcetool.htm**.

The SEC SAR Alert Message Line phone number is 202-551-SARS (7277). This number should only be used when securities firms have filed a SAR that may require immediate attention by the SEC, according to an SEC news release. Calling the SEC SAR Alert Message Line does not alleviate a firm's obligation to file a SAR or notify an appropriate law enforcement authority, such as a local office of either the IRS Criminal Investigation Division or the FBI. General questions on SARs and other Bank Secrecy Act filing requirements may be directed to the Financial Crimes Enforcement Network's Regulatory Helpline at 800-949-2732.

■ **The International Ethics Standards Board for Accountants has proposed changes to the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants.** The IESBA is an independent standard-setting board within IFAC. The proposed changes are intended to clarify the specific requirements contained in the code and refine the application of the code's conceptual framework, according to an IFAC news release.

Comments on the exposure draft are due by Oct. 15. The ED may be viewed at **www.ifac.org/eds**.

■ **GASB issued a *Request for Response on Suggested Guidelines for Voluntary Reporting of SEA Performance Information*** as part of its effort to receive feedback on the board's project to develop standards for state and local governments that voluntarily choose to report on their service efforts and accomplishments (SEA).

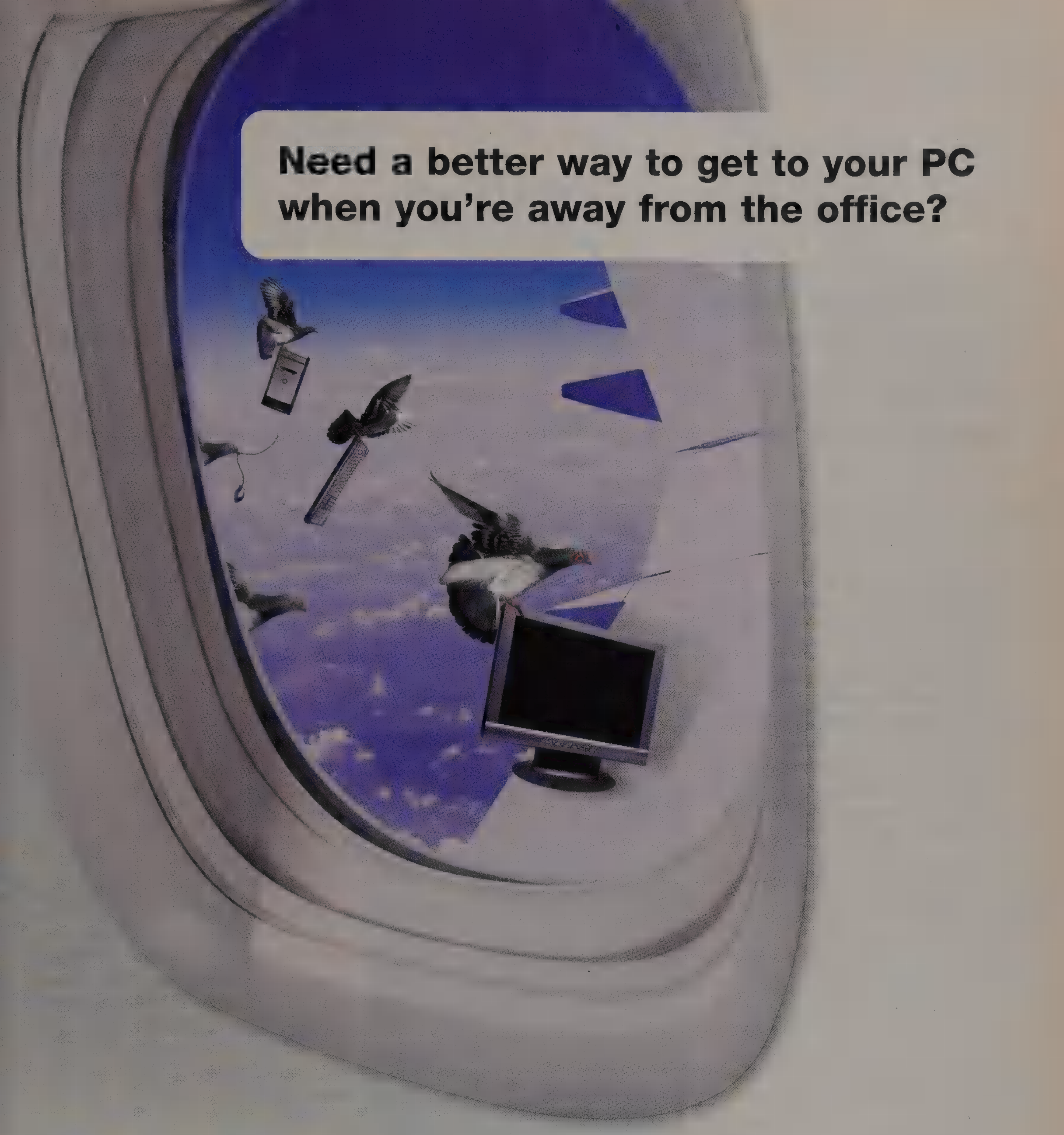
GASB is developing the voluntary standards because the board has determined that SEA performance information provides more information about a government's efficiency and effectiveness in providing services to residents than can be provided by traditional financial statements. It is considered an important method of demonstrating accountability and stewardship.

Comments are due by Oct. 31. The guidelines are available at **www.gasb.org/exp**.

■ **The Pension Benefit Guaranty Corporation published a request for proposals to form strategic partnerships with outside firms to assist with the agency's new strategy of investing in real estate and private equity.**

The PBGC's new policy requires 10% (approximately $5.5 billion) of the corporation's assets to be allocated to private equity and real estate. The RFP seeks two or three firms to manage as much as $2.5 billion in these asset classes. To qualify, firms must have global operations and have successfully managed private equity and real estate allocations, as well as $1 billion in strategic operations in the past three years.

The official solicitation, including details of the services required and instructions for submitting proposals, is available at the federal government's FedBizOpps centralized procurement Web site at **www.fbo.gov**. ❖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NEWS ANALYSIS

Profession Reacts to IFRS Plan

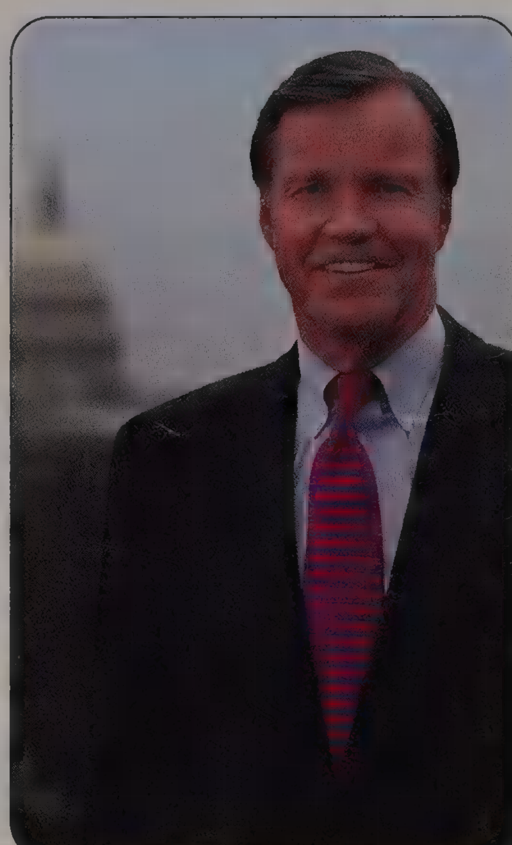
For U.S. GAAP, the end of an era could be in the making. In August, the SEC unveiled a proposed road map that begins to widen the acceptance of International Financial Reporting Standards. The plan could lead to a requirement for U.S. public companies to begin using IFRS by 2014.

"It may be a very long time indeed before the world's six and a half billion people can all speak in the same tongue," SEC Chairman Christopher Cox said at the meeting during which the commission agreed to seek comments on the proposal. "Fortunately, we won't have to wait nearly as long for the language of business and finance to converge. One of the more revolutionary developments in the world's capital markets is the remarkably quickening pace of acceptance of a true lingua franca for accounting."

The road map would allow 110 of the largest publicly held companies—equal to 14% of U.S. market capitalization—to begin using IFRS voluntarily for their 2009 financial statements. The limited early use of IFRS is one of seven milestones the SEC would weigh in 2011 when deciding whether to mandate the use of IFRS. The proposal, now in the comment phase, leaves open the option of sequencing the rollout based on market capitalization.

AICPA President and CEO Barry Melancon expressed support for the SEC moving ahead with the proposal and for the concept of moving to a single set of high-quality global accounting standards for public companies. "The SEC noted education and training as one of the key milestones for the transition," Melancon said. "The AICPA is working to help members and future professionals understand IFRS and acquire the necessary skills to use these standards."

Arleen R. Thomas, AICPA senior vice president–member competency and development, said "the Institute supports an orderly transition from U.S. GAAP to IFRS and believes the U.S. capital markets will insist on IFRS. The SEC's plan continues a robust and thoughtful debate that is critical as the transition occurs."



SEC Chairman Christopher Cox

The *JofA* asked a group of other accounting thought leaders for their views on the SEC's proposal. Here are excerpts of their comments:

UNDERSTANDING THE FULL IMPACT

D.J. Gannon, leader of the Deloitte IFRS Center of Excellence

Many have focused solely on the technical accounting impacts related to IFRS. Understanding the broader impacts that IFRS may have is important to preparing a successful implementation. Assessing other issues like tax, internal processes and controls, regulatory and statutory reporting, technology infrastructure, and organizational issues such as treasury and cash management, legal and contracts, compensation and human resources, and communication is key.

While conversion to IFRS on a consolidated basis may be a few years away, companies can start taking advantage of opportunities now to convert to IFRS for statutory reporting purposes overseas. Many countries already permit the use of IFRS. Converting to IFRS for statutory reporting purposes for subsidiaries in those countries may provide an opportunity to develop a multiyear strategy and a detailed road map for conversion to IFRS. By leveraging the training and experience gained on these statutory conversions, companies can be better positioned to execute a consolidated IFRS conversion in the future.

PREPARATION BEGINS NOW

Dave Kaplan, international accounting leader, PricewaterhouseCoopers

IFRS is well-established and a sufficiently high-quality and robust system of financial reporting, and it will become part of our lives. As a profession, it's in our best interest to learn about it and become proficient in it.

One of the challenges is the issue of GAAP reconciliation. The SEC laid out two options in its proposal—one calling

for the traditional IFRS first-time adoption reconciliation, the other requiring that step plus an ongoing unaudited reconciliation of the financial statements from IFRS to U.S. GAAP. Clearly the second one is a more costly approach for companies and for investors who at the end of the day would bear the expense. A well-run company would want to address that by running parallel or dual systems.

IFRS EXPECTED TO INCREASE INVESTOR CONFIDENCE

Cindy Fornelli, executive director, Center for Audit Quality

We believe investors would benefit substantially if the participants in all of the major markets agreed on a common, easily accessible and understandable accounting language. If IFRS is to become the favored language of the accounting and business worlds, it should speak to the world's investors first and foremost.

Sixty-two percent of investors surveyed by the CAQ [in July] told us the creation of a single, uniform, international set of accounting standards would give them a higher level of confidence. Our hope is that IFRS will enable investors to more easily compare financial results of publicly traded companies in every corner of the world.

DON'T PUT INVESTORS IN THE BACK SEAT

Jack T. Ciesielski, owner of R.G. Associates Inc., former member of FASAC, AcSEC and FASB's EITF

I certainly support convergence, but I'm cautious. I don't want investors to suffer a loss of information or a decrease in the quality of information that they've become accustomed to receiving under U.S. GAAP. This is a monumental undertaking, almost as complicated as a moonshot, and I would hate to see investor information take a back seat to political expediency.

There are plenty of places where IFRS and U.S. GAAP are close, but the nuances of standards application can propel differences that last for years. There are plenty of accounting choices between the two that can produce accounting differences that last for years. How will the convergence process deal with these lasting differences? Or any differences, for that matter?

Some are obvious: We allow choices between LIFO and FIFO, while under IFRS, LIFO cannot be used. If we were to eliminate LIFO usage here, would the SEC require "early adopters" to restate past statements under FIFO assumptions so that investors would clearly see the change's effect on trends? That could be a very cumbersome, perhaps impossible, task for some firms. Would the SEC give them a free pass?

> The limited early use of IFRS is one of seven milestones the SEC would weigh in 2011 when deciding whether to mandate the use of IFRS.

I am concerned that in speeding up the U.S. to achieve convergence with other IFRS-using regimes, the SEC may give up too much from the investor's point of view to hasten the process. The benefits to investors have often been framed as "more choices, better information," but more choices don't always mean better investing, and better information depends on how standards are applied.

FIRST STEPS FOR ISSUERS

Aaron Anderson, director, IFRS policy and implementation, IBM

While the accounting differences between IFRS and U.S. GAAP may be significant for your company, there are several fundamental questions that should be answered before this comparison is started.

First, where are you doing IFRS today? If you have operations in Europe, Australia, Israel, China and dozens of other countries around the world, you're likely preparing statutory reports in some form of IFRS already. In answering this question, you will have to go deeper than the name of the country's accounting standard. Specifically, is a country's GAAP really "IFRS by a different name" or is it called IFRS—but is not?

Second, what adjustments are you currently making between your U.S. GAAP books and your statutory books prepared in accordance with IFRS? In most cases, these financial statements are audited and will provide you with a good starting point for determining the GAAP differences impacting your company.

Third, what benefits can you derive from the use of one GAAP for both statutory and consolidated reporting? That is, would adoption of IFRS globally by your company create opportunities for a broader finance transformation project that would increase standardization, centralization of processes, and realization of economies of scale? Are you a candidate for opting to report in IFRS under the criteria proposed by the SEC?

Finally, who in your organization would be impacted by a change from U.S. GAAP to IFRS? Studies have indicated that a strong internal, cross-functional team is a key element of a successful IFRS conversion. Identifying the various functional impacts of a change in accounting standards—and getting the buy-in from the leaders of those functions—will allow you to focus your company's response to IFRS.

ACCOUNTING EDUCATION: READY FOR THE CHALLENGE

David R. Campbell Sr., head, Department of Accounting, Drexel University

From an educational perspective we are better positioned than most countries for the transition, since the United States has one of the strongest platforms for devel-

oping entry-level accounting professionals globally.

We will definitely be challenged. However, the theoretical foundations underpinning U.S. GAAP and IFRS are similar—and merging through convergence—and I'm confident that accounting educators will respond to our changing environment and deliver high-quality students ready to enter and provide leadership in the global IFRS financial reporting arena in the coming years.

Based upon my experience in Europe during the transition period from national GAAPs to IFRS, I view the SEC road map as an opportunity to rethink financial reporting across all dimensions. Those in the C-suite should not overlook their increased responsibilities in setting sound accounting policies that fit their business model, and they must be ready to explain and justify these policies in the context of the IFRS framework.

CHOOSING A PATH FOR PRIVATE COMPANIES

Judith O'Dell, chair, Private Company Financial Reporting Committee (PCFRC)

In all of the publicity surrounding the SEC road map, little mention has been made of its effect on private companies. For the past year, the PCFRC has been discussing and presenting at CPE sessions possible scenarios for private companies once public companies are required to convert to IFRS.

We see five possibilities: IASB's International Financial Reporting Standard for Private Entities, which is in development; a U.S.-adapted version of the Private Entities document; IFRS with differences for private companies; separate U.S. private company GAAP; U.S. GAAP maintained and updated for private companies.

There are pros and cons to each of these approaches, and some are dependent on maintaining a standard-setting body in the U.S. One question to be answered is whether the IASB's Private Entities document will meet the needs of and be accepted by users of U.S. private company financial statements.

Since the AICPA has approved the IASB as a GAAP-setting body, a private company more easily can adopt IFRS tomorrow or adopt the Private Entities document once it is approved by the IASB.

One advantage smaller private companies have over some of their foreign counterparts is the ability to report using income tax or cash basis financial statements, and I don't see that changing. ❖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News, People, Trends and Other Noteworthy Items

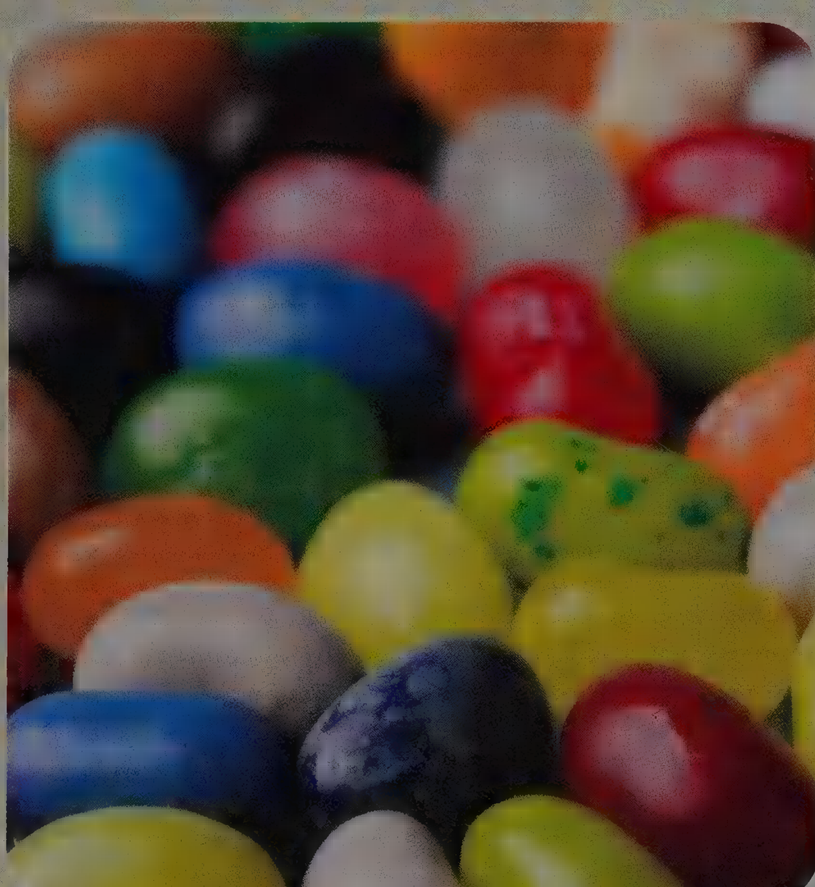
CAREERS AND RECRUITING

Investments in Diversity Pay Off

You heard it straight from the recruiter's mouth: Companies with diversity programs enjoy a competitive advantage when it comes to recruiting top talent.

An overwhelming majority—nearly nine out of 10 executive recruiters—thought effective diversity programs provide a more robust talent pool.

According to Korn/Ferry International's *Executive Recruiter Index*, more than two-thirds (68%) of executive recruiters thought executive leadership should be driving an organization's diversity efforts, followed by the board of directors (13%), human resource department (11%) and diversity committee (8%).



Source: Korn/Ferry International, **www.kornferry.com.**

FRAUD

High-Tech Fraud Prevention

Even small businesses that have been victims of employee fraud are failing to put proper systems in place to prevent future occurrences, according to a Sage Software survey conducted by M/A/R/C Research. The findings suggest proper use of accounting software may be a valuable weapon in a company's fraud-prevention arsenal.

The survey found that 21% of small businesses did not have a system in place to prevent employee fraud and another 13% didn't know if they did or not. Furthermore, about a quarter of companies that have suffered fraud losses in the past have not established preventive measures. Twenty-eight percent of small businesses that responded to the survey said they had been victimized at some time by employee fraud.

Of the respondents that had internal control systems in place to prevent fraud, 47% were using their accounting software as a fraud-prevention tool.

Source: Sage Software,
www.sagesoftware.com/newsroom/news/index.cfm.

BUSINESS TRENDS

Charitable Giving Passes $300 Billion in 2007

Despite worries about the economy, last year donations to public charities exceeded $300 billion for the first time.

A report from the Giving USA Foundation estimates charitable giving reached $306.4 billion last year, an increase of 3.9% from the previous year (though only a 1% increase when adjusted for inflation). Every type of public charity saw an increase in donations—the first across-the-board increase since 2001.

The foundation attributes the increase in 2007 to stock market performance in the first half of the year and increases in corporate and personal income.

Source: *Giving USA 2008*, **www.givingusa.org**.

CAREERS AND RECRUITING

Get Personal

In a recent survey by Accountemps, half of CFOs polled said interpersonal abilities are the most important communication skills for accounting and finance professionals.

Other in-demand communications skills include:

- Presentation and public speaking ability–17%
- Negotiation skills–16%
- Writing ability–12%

Source: Accountemps, **www.accountemps.com**.

TECH TALK

Internal Auditors: ISO 27000 the Top Tech Need

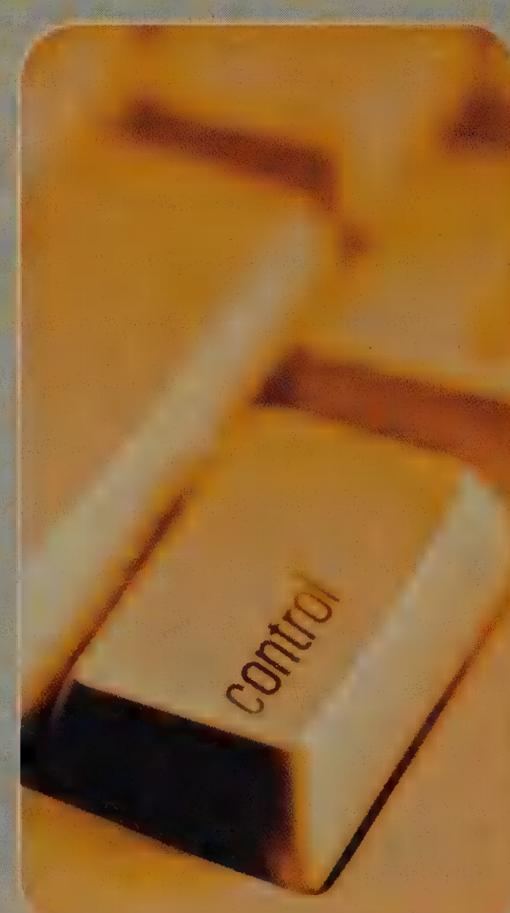
When it comes to information security know-how, many internal auditors said they wouldn't make the grade.

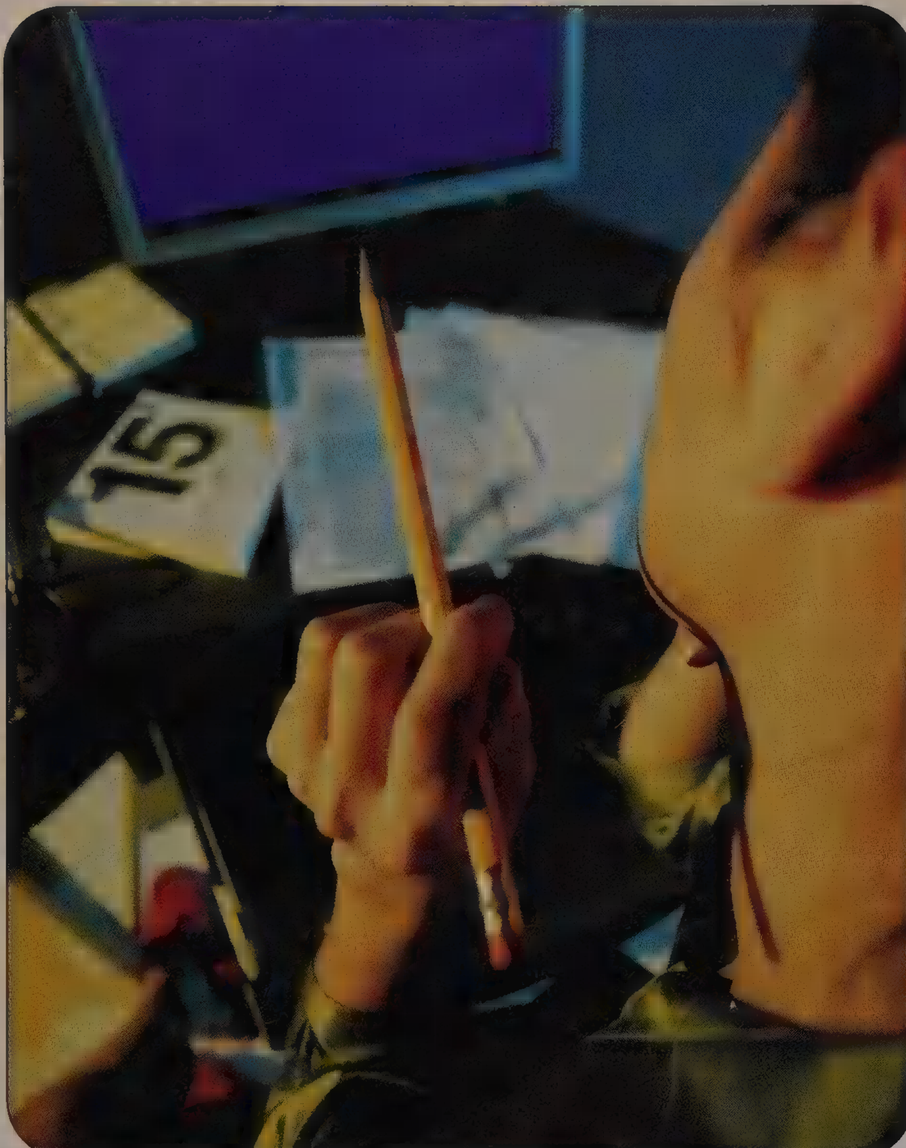
The *2008 Internal Audit Capabilities and Needs Survey* from Protiviti found that among internal auditors, the top technical competencies in need of improvement were ISO 27000, enterprise risk management (ERM) and fraud risk management (FRM).

Chief audit executives constituted more than a third of the 516 audit professionals who participated in the study. CAEs also named ISO 27000, the certification standard for information security developed by the International Organization for Standardization, as their top competency in need of improvement, followed by COSO and FRM.

ISO 27000 was not listed in the 2007 *Capabilities and Needs* survey. Bob Hirth, executive vice president of global internal audit solutions for Protiviti, said in a release, "An ever-increasing reliance on IT-generated data and the plethora of data security breaches are contributing to the need for internal auditors to enhance their skills in this critical area. Clearly, more organizations view themselves vulnerable to such risks and are relying on internal auditors to help mitigate and monitor them."

Source: *2008 Internal Audit Capabilities and Needs Survey*, **www.protiviti.com/go/2008capabilitiesandneeds**.





TAX NOTES

IRS Boosts Online Payment Agreement Application

It's now easier for tax practitioners and taxpayers to make changes to installment agreements, thanks to the addition of several new features to the Service's Online Payment Agreement application.

The interactive application now allows:

- Individuals to revise due dates and payment amounts on existing agreements.
- Individuals to revise existing regular and direct deposit installment agreements and extensions to those agreements.
- Tax practitioners with valid authorizations to use either the signature date found on their approved Form 2848, *Power of Attorney and Declaration of Representative*, or the caller ID as an alternate way to authenticate when requesting agreements for clients.

According to the IRS, more than three-quarters of taxpayers eligible for an installment agreement can establish one using the online application, which has been used by more than 30,000 taxpayers since its launch in October 2006.

Source: The IRS, **www.irs.gov**.

DATA POINTS

22

Percentage of HR executives who said their firm blocks access to social networking Web sites, such as LinkedIn and MySpace.

8

Percentage of HR executives who said their firm encourages employees to use such sites.

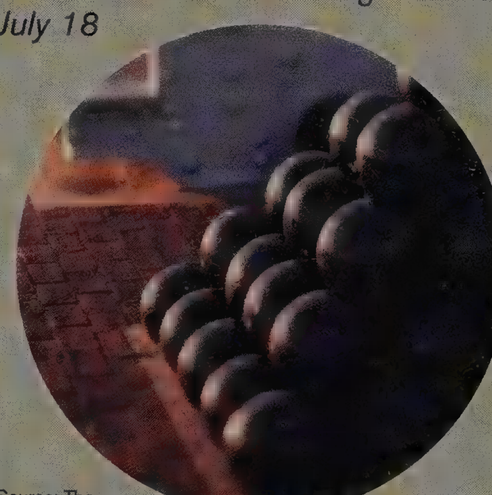
Source: Challenger, Gray & Christmas Inc., **http://challengeratworkblog.blogspot.com**.

ON THE RECORD

Diversifying the Tax Collection Arsenal

"We cannot audit our way to full compliance. ... We need to supplement our efforts with new tools, such as more information reporting, soft notices and self-correction options for taxpayers."

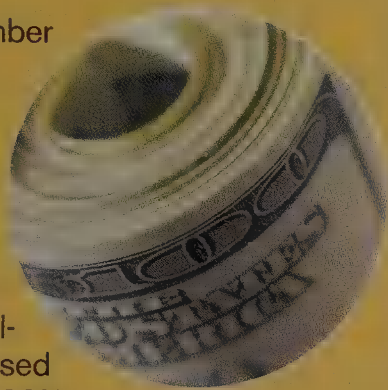
—IRS Commissioner Doug Shulman, July 18



Source: The IRS, **www.irs.gov**.

SMALL BUSINESS

Small Firm Lending Accelerated in 2007



The number of outstanding small business loans between $100,000 and $1 million increased by almost 32% between June 2006 and June 2007, according to the Office of Advocacy of the Small Business Administration.

The study, *Small Business and Micro Business Lending in the United States for Data Years 2006–2007*, found that the total number of small business loans (including those under $100,000) increased by 15% while the total dollar value of loans increased by about 8%.

All of these were higher rates of growth than over the June 2005 to June 2006 period.

Source: Office of Advocacy, SBA, **www.sba.gov/advo/research/sbl_07study.pdf.**

BUSINESS TIPS

Avoiding Mixed Messages

It may be easy to get a message across in your native tongue, but there are numerous hurdles and risks to overcome when you're asked to deliver your message in another language.

Susana Baumann, director of LCSWorldwide Language and Cultural Services, shared her tips for successful translation projects with the Oklahoma Society of Certified Public Accountants.

Baumann suggests the following steps when preparing a project—particularly marketing or branding materials—for translation:

- Remove regional or common expressions from the text.
- Review and finalize the text before sending it to a translator.
- Prepare a glossary for a consistent translation.

For more tips on translation preparation and steps to follow when choosing a translation service provider, see Baumann's article, "¿Habla Español? When New Business Depends on It," at **www.oscpa.com/includes/showwire.asp?i=564**.

Source: OSCPA, **www.oscpa.com.**

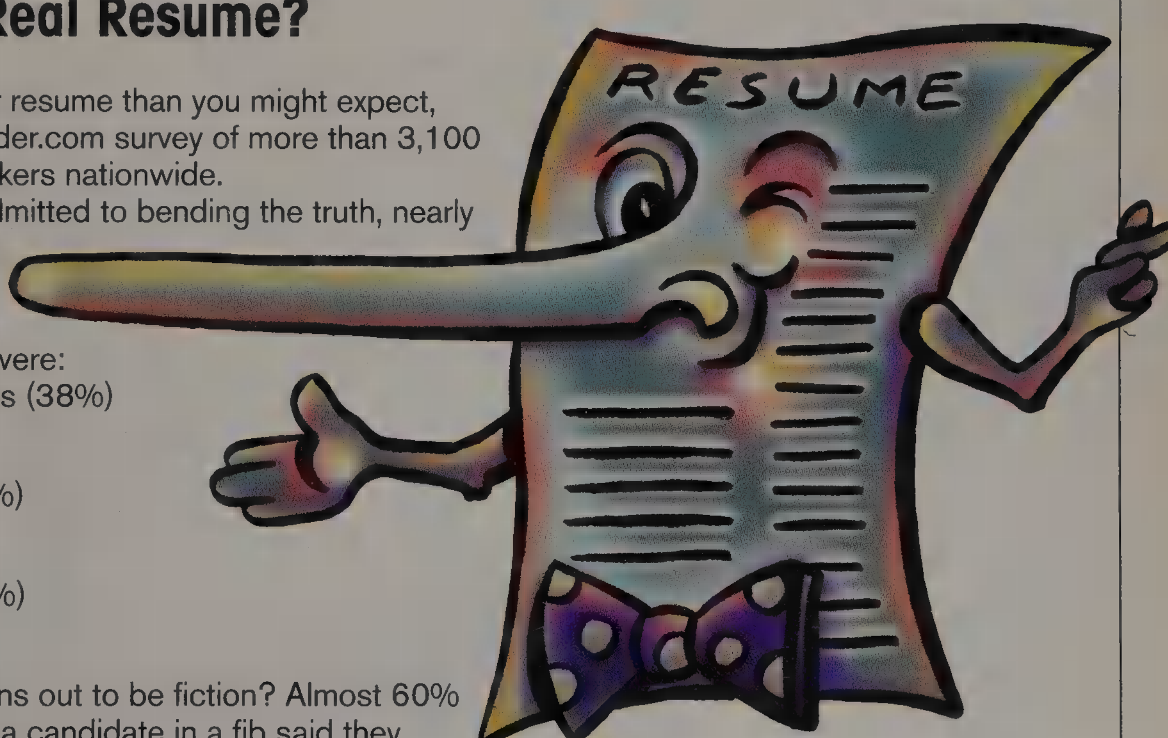
CAREERS AND RECRUITING

Can You Spot the Real Resume?

More job-seekers lie on their resume than you might expect, according to a CareerBuilder.com survey of more than 3,100 hiring managers and 8,700 workers nationwide.

While only 8% of workers admitted to bending the truth, nearly half of hiring managers reported they caught a candidate lying on a resume. The most common resume lies reported were:

- Embellished responsibilities (38%)
- Skill set (18%)
- Dates of employment (12%)
- Academic degree (10%)
- Companies worked for (7%)
- Job title (5%)



What happens when fact turns out to be fiction? Almost 60% of hiring managers who caught a candidate in a fib said they automatically dismissed the applicant.

Source: **www.careerbuilder.com.**

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AUDITING

■ The PCAOB adopted rules that will allow certain registered firms to provide audit services without a break in their PCAOB registration status when there has been some change in their legal form.

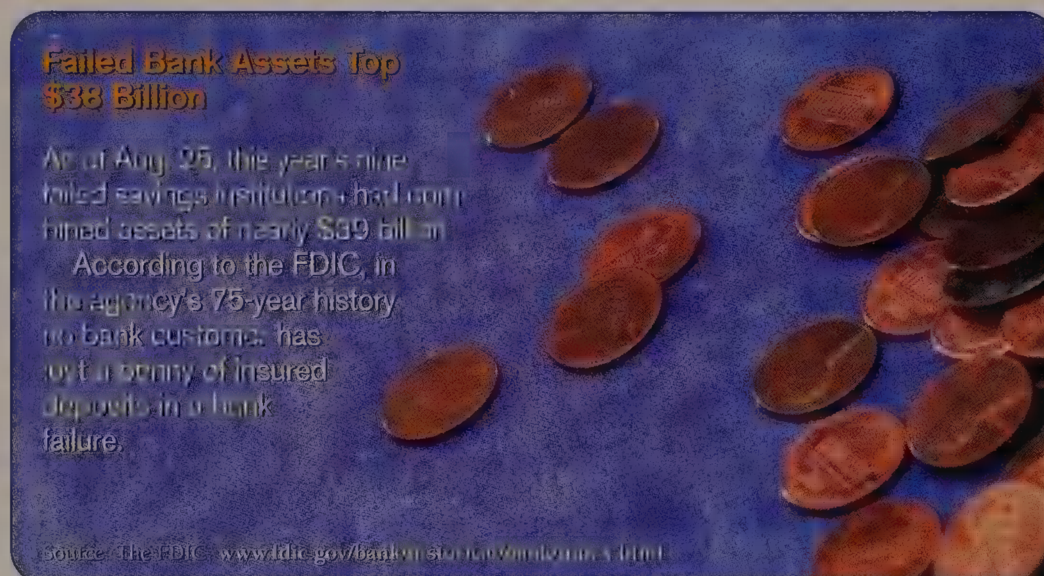
Under section 102(a) of the Sarbanes-Oxley Act and PCAOB rules, a public accounting firm must be registered with the PCAOB to prepare or issue audit reports for public companies or to play a substantial role in such work. To become registered, an accounting firm files an application for registration on PCAOB Form 1, which the board may approve or disapprove. The new rules and form—PCAOB Form 4—identify circumstances in which the registration status of a registered firm may continue in effect even after the firm's legal form has changed or the firm has combined with another firm, without the new legal entity needing to apply for registration on Form 1.

The rules would take effect 60 days after SEC approval. The text of the rules and the instructions to Form 4 can be found on the PCAOB Web site, **www.pcaobus.org**, under the rulemaking docket.

BANKING

■ The FDIC added a tool to its Web site that allows depositors at failed institutions to determine coverage on their deposits. The tool is available to depositors of insured institutions that fail after July 1, 2008. The first depositors to use the tool were from IndyMac Bank, the $32 billion institution that failed in July. Through Aug. 25, four banks had been added: First Heritage Bank of Newport Beach, Calif., First National Bank of Reno, Nev., First Priority Bank of Bradenton, Fla., and The Columbian Bank and Trust of Topeka, Kan.

The tool is at **www4.fdic.gov/dip/index.asp**. The FDIC says the tool is available to depositors no later than the first business day after a failure.



FINANCIAL REPORTING

■ The SEC's Advisory Committee on Improvements to Financial Reporting (CIFiR), submitted its final report in August. The report makes 25 recommendations that could be implemented by the SEC, FASB and the PCAOB.

The CIFiR report provides practical proposals to improve financial reporting in five main areas: (1) increasing the usefulness of information in SEC filings; (2) enhancing the accounting standards-setting process; (3) improving the substantive design of new standards; (4) delineating authoritative interpretive guidance; and (5) clarifying guidance on financial restatements and accounting judgments.

Among other things, the committee noted in the first area that many individual investors find company filings with the SEC to be overly complex and detailed. Thus the committee recommended including a short executive summary at the beginning of a company's annual report that would describe concisely the main aspects of its business and its key performance metrics.

In the second area, the committee called for more investor participation in accounting standard setting by increasing investor representation on the boards of FASB and the Financial Accounting Foundation.

In the third area, the committee noted that the underlying objectives of certain accounting standards are sometimes obscured by dense language, detailed rules and numerous exemptions. The committee recommended another approach to the substantive design of standards. For example,

it called for improved rules on off-balance-sheet accounting and fewer situations where alternative accounting standards exist for the same transaction. The committee recommended that companies provide better disclosure to investors about what portion of their earnings constitutes cash or accrued income based on historical cost accounting and what portion represents unrealized gains or losses based on fair value estimates.

To reduce the proliferation of U.S. GAAP, the committee said it strongly supports FASB's efforts to complete the codification of all authoritative accounting literature into one document. The committee said that others such as audit firms may still publish their views on accounting issues, but they should be labeled as nonauthoritative. In this fourth area, the committee also called for a clearer delineation of functions on interpreting accounting standards—with FASB taking the lead on broad issues and the SEC on registrant-specific issues.

In the fifth area, the committee recommended increased correction of accounting errors and more disclosures about those corrections to investors. However, the committee warned that correcting every accounting error should not automatically result in a lengthy process of restating financial statements for several prior years. The committee said that in the "dark period" during restatements when companies generally cease filing current financial reports, companies usually do not provide investors with much information. Thus, the committee said it believes that restatements of prior years should be undertaken for correcting accounting errors that are material to current investors.

The SEC already has taken steps based on two earlier recommendations made by the CIFiR. On May 14, the SEC formally proposed using XBRL technology to get important information to investors faster, more reliably, and at a lower cost by requiring all U.S. companies to provide financial information using XBRL beginning as early as next year. And on July 30, the SEC approved new guidance to public companies to address their concerns about how to comply with the securities laws while developing their Web sites to serve as an effective means for disseminating important information to investors.

To view or download the report, visit **www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf**.

■ FASB board members support a 2010 adoption date for proposed amendments to FASB Statement no. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* and FASB Interpretation no. 46 (revised December 2003), *Consolidation of Variable Interest Entities*.

The board decided on a single effective date for fiscal years beginning after Nov. 15, 2009. The board also decided to separately issue a FASB Staff Position that would require additional disclosures as soon as possible.

The board clarified that the initial consolidation of a variable-interest entity as a result of the initial application of the proposed amendments to FIN 46(R) would require an enterprise to initially measure all assets and liabilities at fair value, with any difference being recorded as a cumulative effect adjustment to retained earnings that would be recorded as of the beginning of the first fiscal year in which the proposed amendments are initially applied.

Many of the disclosures approved for the proposed amendments to Statement no. 140 and FIN 46(R) at FASB's June 4, 2008, board meeting will be included in a separate FSP. The proposed FSP will require a non-transferor enterprise that holds a significant variable interest in a qualifying special-purpose entity to make certain disclosures required by the proposed amendments to the FIN 46(R) disclosures. The proposed FSP will be effective as soon as possible, but no later than the first interim reporting period in 2009. It will apply only to public companies.

The purpose of a disclosure-only FSP is to meet financial statement user needs for

greater transparency for off-balance-sheet transactions as well as to provide preparers and others with adequate time to consider and implement the other proposed amendments to Statement no. 140 and FIN 46(R).

■ FASB will defer the development of a new accounting model for lessors. Its lease-related project will address only lessee accounting. The board also agreed with an overall approach to generally apply the finance lease model in International Accounting Standard (IAS) 17, *Leases*, adapted where necessary, for all leases.

The board decided to require lessees to include contingent rentals in the measurement of the right-of-use asset and the lease obligation based on their best estimate of expected lease payments. Both the right-of-use asset and the lease obligation should be initially measured at the present value of the best estimate of expected lease payments for all leases. Options to extend or terminate the lease would be included in the measurement of the right-of-use asset and the lease obligation based on the best estimate of the expected lease term. Contractual factors, non-contractual factors and business factors should be considered when determining the lease term, the board concluded.

FRAUD

■ The Financial Crimes Enforcement Network issued guidance to casinos and card clubs with "red flags" that may indicate the presence of money laundering, terrorist financing and related financial crimes.

FinCEN's guidance FIN-2008-G007, *Recognizing Suspicious Activity—Red Flags for Casinos and Card Clubs*, gives examples of activities that may be attempts to evade Bank Secrecy Act reporting or recordkeeping requirements, such as minimal gaming activities without reasonable explanations. The red flags are based on actual suspicious activity reports, observations of examiners, and experience of law enforcement.

The guidance is available at **www.fincen.gov**.

GOVERNMENT

■ GASB issued a proposed technical bulletin that clarifies that the use of actual known amounts for purposes of calculating the annual required contribution (ARC) adjustment relating to pensions and other post-employment benefits (OPEB) is consistent with the intent of existing standards. The proposed technical bulletin, *Determining the Annual Required Contribution for Postemployment Benefits*, clarifies that using the known amount in place of the estimation procedure in GASB Statement no. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement no. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, is encouraged.

Statements no. 27 and no. 45 assume that the ARC adjustment is not known and require governments to use a method of estimation. Since it has come to GASB's attention that some actuaries do track that portion of the ARC separately, the proposed technical bulletin will clarify that governments may base the ARC adjustment on the actual amount when it is known.

The proposed technical bulletin is available at **www.gasb.org/exp**.

INTERNATIONAL

■ The trustees of the International Accounting Standards Committee (IASC) Foundation published a discussion document containing proposals that would establish a formal link between the IASC Foundation and a monitoring group composed of representatives of public authorities and international organizations that are accountable to public authorities. The proposals would also expand the membership of the International Accounting Standards Board (IASB) to 16 members and add new guidelines regarding the geographical diversity of the membership.

The establishment of the link to a monitoring group is aimed at enhancing the transparency and public accountability of the IASC Foundation, while not impairing the independence of the standard-setting process, according to an IASC Foundation news release.

The discussion document, *Review of the Constitution: Public Accountability and the Composition of the IASB—Proposals for Change*, is available at **www.iasb.org/NR/rdonlyres/12CC476D-B88F-418A-826F-71A7465FC2E0/0/Proposal_and_issues_for_the_Constitution.pdf**.

INVESTING

■ Although investors are less confident in U.S. capital markets than they were a year ago, 70% or more continue to voice confidence in the markets and U.S. companies in general, as well as in audited financial statements, according to the Center for Audit Quality's second annual survey of investors.

Seventy percent of investors who were surveyed between July 10 and July 20 expressed confidence in U.S. capital markets, down from 84% in July 2007.

Complicated Reports Ignored by Investors

Fifty-five percent of investors polled in a Center for Audit Quality survey said they rarely or never read the financial reports of U.S. companies. The top reasons given were:

- Too difficult to understand (27%)
- Doesn't have an impact on my investment behavior (18%)
- Contain unreliable information (11%)
- Not easily available/Don't know where to find (6%)
- No specific reason (32%)

Source: *Report on the Center for Audit Quality's Second Annual Survey of Investors*, **www.thecaq.org/newsroom/pdfs/july2008investorsurvey.pdf**.

Rising gas and oil prices, the weakness of the dollar and the home foreclosure crisis were the top reasons for their reduced faith. Public confidence in audited financial statements was 73%—down from 80% a year ago.

A larger number of investors now describe themselves as "inexperienced" investors, with a corresponding increase in reliance on a broker or money manager. Eleven percent of investors say they have diversified their portfolios. The survey also found that nearly half of investors (45%) read companies' financial reports "very" or "somewhat" often, but that many find the reports hard to use. Respondents voiced strong support (72%) for the design of a more user-friendly way of accessing and reading financial reports.

The relevance of financial reporting was the dominant theme of the CAQ's recently concluded Public Dialogue Tour, according to CAQ Executive Director Cindy Fornelli. "In 10 cities across the country, the public company auditing profession heard from a variety of stakeholders that modernizing the business reporting model—and doing so in a manner that puts investors' needs first—should be our highest priority," Fornelli said in a press release. "That will be the primary focus of the Tour's final report to be issued later this year."

In addition to the design of more user-friendly financial reports, other proposals that investors said would give them a higher level of confidence are:

- Creating an institute for auditing firms to share experiences and develop best practices for fraud prevention and detection (67%).
- Allowing investors to access financial reports in a way that is customized to their specific interests and expertise (63%).
- Requiring enhanced levels of public disclosure that provide investors with more information when public companies change auditors (63%).
- Creating a single, uniform, international set of accounting standards (62%).

The survey summary and the complete questionnaire are posted on the CAQ's Web site, **http://thecaq.org/newsroom/pdfs/july2008investorsurvey.pdf**.

■ Secretary of Labor Elaine L. Chao and SEC Chairman Christopher Cox signed a memorandum of understanding (MOU) that formalizes cooperation to share information relating to retirement and investments, and provide investors, benefit plan participants, and plan administrators with better access to more understandable information for making informed investment decisions.

The MOU establishes a process for the Labor Department's Employee Benefits Security Administration and SEC staff members to share information and meet regularly to discuss matters of mutual interest, including examination findings and trends, enforcement cases, and regulatory requirements that impact the missions of both agencies.

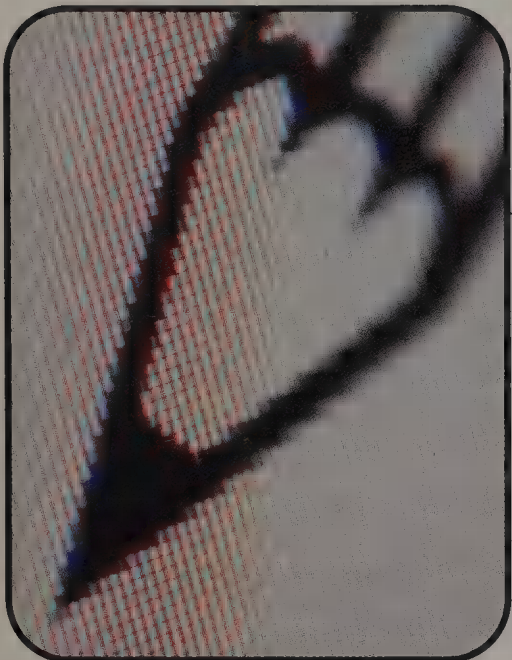
For a copy of the MOU, visit **www.dol.gov/opa/media/reports/mou072908.pdf** or **www.sec.gov/news/press/2008/mou072908.pdf**.

PENSIONS

■ Public pension plans that invested in alternative assets such as hedge funds had significantly higher standard deviations in return over a five-year period relative to other pension plans but did not have significantly different returns over the same period after measuring risk-adjusted returns with the Sharpe Ratio. The Office of the Comptroller of the Currency released the data in the work paper *Alternative Assets and Public Pension Plan Performance*.

The paper says plans that invested in hedge funds in 2006 did not have significantly different investment returns compared with those that did not invest in hedge funds. The paper says returns for funds that had 10% or more of their assets in alternative investments performed worse than other pension funds in 2002 and 2003 and significantly better overall in 2004, 2005 and 2006.

The authors say more "seasoned data" must be compiled before any strong conclusions can be made about the effects of hedge funds on public pension funds. The work paper is available at **www.occ.gov/ftp/workpaper/wp2008-2.pdf**. ❖



CHECKLIST

Nexus for Sales and Use Taxes

States have become more aggressive in claiming a seller has substantial nexus for sales and use tax purposes. They look for in-state activities, relationships and assets of unregistered businesses with customers in the state. Here are some tips to help businesses determine their sales and use tax collection obligations:

✔ ***Review "physical presence" law.*** The 1992 U.S. Supreme Court decision in *Quill Corp. v. North Dakota*, 504 U.S. 298, held that a seller must have a physical presence in a state before the state can require sales tax collection. The types of physical presence that create nexus, however, vary from state to state. State statutes, regulations, tax agency rulings and court decisions should be reviewed regularly for developments. The AICPA offers a directory of Web links at **www.aicpa.org/yellow/yptstax.htm**.

✔ ***Know where property is located.*** Verify the location of inventory, goods out on consignment, leased property, real property, equipment, computer servers and delivery trucks. Just about any property—perhaps even intangible property such as software—that a state may treat as tangible can create nexus.

✔ ***Know the whereabouts and activities of employees and representatives.*** Employees, independent contractors, agents or representatives in a state may create nexus, depending on the nature of the relationship and activities. Again, states vary as to definitions, exceptions, time limits and the types of activities the person or entity may engage in that create nexus. Generally, the activities must relate to sales. Some nexus rulings refer to *Tyler Pipe Industries Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987): "... the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales."

✔ ***Examine the nature of transactions and relationships in the state.*** Some states have broadened the types of relationships that can create nexus. For example, a few states, such as Arkansas, Idaho and Minnesota, provide that if a seller and in-state business have a specified relationship and the in-state business in some way promotes sales for the seller or has similar products or company name, the seller must collect sales tax.

In April 2008, New York modified its sales tax law to create a presumption that a seller is soliciting business through resident representatives if it compensates them for directly or indirectly referring customers. Thus, sellers who allow "associates" who reside in the state to place a link on their own Web page and earn commissions for sales generated when customers use the link may be subject to sales tax collection obligations in New York. (Online retailers Amazon.com and Overstock.com have filed suit challenging the law's constitutionality—see "Tax Matters: Online Retailers Battle N.Y. Nexus," page 96.) Most states, however, treat advertising alone as not creating nexus.

✔ ***Take into account multistate operations and mobile customers.*** A recent ruling involved a tire dealer with locations in four states including Massachusetts and New Hampshire, which has no sales tax. The Massachusetts Appellate Tax Board held that the seller's New Hampshire stores should have collected use tax when they installed tires on Massachusetts cars, since employees could readily tell from the license tag where the tires would be used. (*Town Fair Tire Centers v. Commissioner of Revenue*, docket no. C280607 (6/08))

✔ ***Always ask questions.*** Avoid past-due tax liabilities, penalties and interest by regularly inquiring into the business and Internet activities of clients and employers. An individual's sale of a few used items on an auction Web site might grow into what a state might consider a business with sales tax collection obligations. New services, such as on-site training, might be offered, or new employees may work out of state and create new tax collection obligations.

*—By **Annette Nellen**, Esq., CPA, a tax professor and director of the MST Program at San José State University and an Irvine Fellow at the New America Foundation. She is a member of the Individual Income Tax Technical Resource Panel of the AICPA Tax Division. Her e-mail address is anellen@sjsu.edu.*

SMART STOPS

On the Web

TAX

A TAX TOOLBOX

www.irs.gov/taxpros/article/0,,id=118004,00.html

This Smart Stop from the IRS provides a host of basic tools for tax professionals, handily compiled onto one page for easy access. The information ranges from recent tax law changes to standards of practice and Circular 230 information to the contact info for the Taxpayer Advocacy Panel (see "The Taxpayer Advocacy Panel: An Opportunity to Collaborate With the IRS," *JofA*, Sept. 08, page 68). The page contains a host of publications on representing clients before the IRS, as well as requesting client transcripts and copies of their tax returns. Also look under "IRS Collection Tools and Your Clients Rights" for rules on representation and disclosure and Offer in Compromise guidelines.

HOMEBUYERS TAKE NOTE

www.federalhousingtaxcredit.com

Visit this new site from the National Association of Home Builders for an overview of the Housing and Economic Recovery Act of 2008, which authorizes a tax credit for qualified first-time buyers purchasing homes before July 1, 2009. The "Frequently Asked Questions" page answers both general and technical questions regarding the credit, or click on "The Law's Other Provisions" to go beyond the act's tax credit provisions and learn about its implications for property taxes, mortgage revenue bonds and Federal Housing Administration modernization. If you're still looking for information, the "Home Buyer Resources" page hosts a list of links to helpful government Web sites, including state and local homebuyer assistance programs.

GENERAL INTEREST

BACK TO SCHOOL

www.adsphd.org

Check out this Smart Stop for information on the new Accounting Doctoral Scholars program, which aims to reverse the shortage of Ph.D. accounting faculty at U.S. colleges and universities and will enroll its first class in the fall of 2009 (see "Highlights," *JofA*, Sept. 08, page 18). The site provides a list of participating universities, firm sponsors, frequently asked questions and the program's online application. More than 70 of the country's biggest accounting firms and several state societies have committed almost $15 million to the program, which is administered by the AICPA Foundation.

ITEMIZE YOUR INVENTORY

www.knowyourstuff.org

Sure, you save receipts, write down serial numbers and generally know what you own, but could you list everything in your home or office after a disaster or freak accident? The Know Your Stuff software from the Insurance Information Institute (III) lets you take inventory with ease. Download the software and watch the "Taking Inventory" video guide to get started or print the home inventory lists created by the III by clicking "Download." As you buy or cast off possessions, it's easy to update the list. Follow instructions to upload photographs and receipts. Once complete, the inventory can be printed and saved at another location or uploaded to an external drive. As a privacy safeguard, the III does not have access to your personal home inventory files.

A VIEW FROM THE INSIDE

http://viewpoints.bonadio.com

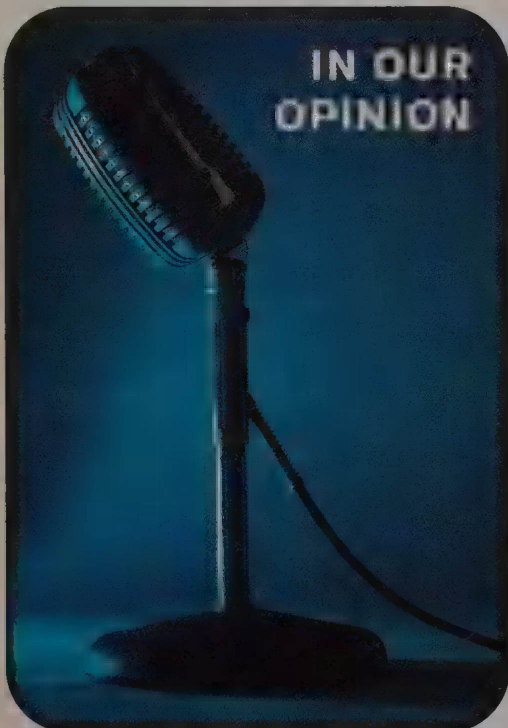
For practical, hands-on observations and information on contemporary accounting, financial management, and wealth management issues, try this site's "Viewpoints." Each podcast, from the partners, principals and staff of The Bonadio Group, an upstate New York-based CPA and financial services firm, includes a printable PDF with a downloadable audio file (which can also be played in your browser window). The site has several "channels," including ones for medium and large private companies, small businesses, not-for-profit organizations and public companies. The Bonadio Group offers free subscriptions to each channel, which pushes new Viewpoint programs to you as soon as they're available.

ACCESS IFRS

http://pwc.blogs.com/ifrs

Read articles such as "Interim reporting—is compliance enough?" and "U.S. move to IFRS—the ball is rolling" from PricewaterhouseCoopers LLP's Global Chief Accountant Richard Keys at the firm's IFRS blog. Keys, also a PwC partner and member of its Global Assurance Leadership Team, delivers IFRS news and analysis from a European perspective. You can link to other PwC blogs on topics such as corporate reporting and finance, and access other IFRS sites and publications, including PwC's U.S. IFRS Web site, **www.pwc.com/usifrs**, which has an interactive IFRS financial statements demo.

—*Megan Pinkston*



CPA MOBILITY

Freedom of Choice is Good for Businesses *and* Consumers

by Patrick C. Lynch and Bob McDonnell

(Editor's note: Advocates for licensing reform approached two state attorneys general for their bipartisan perspective on the mobility issue.)

In an increasingly global economy, business no longer stops at national borders much less at state lines. With advancements in technology, even relatively small companies have little difficulty extending operations across the nation. All businesses—big and small—need the services of certified public accountants. But should CPAs' ability to provide services to their customers end at the state line? We think not.

As more businesses expand their operations into multiple states, it is increasingly vital to the efficiency of those companies that their CPAs have the ability to cross the same state lines to provide high-quality services. Virginia and Rhode Island have been leaders in taking a regulatory approach that allows licensed, out-of-state CPAs to enter our states freely to provide services. At the same time, regulators have important new tools for tough disciplinary action against CPAs who violate the rules. We believe that all states should embrace such a regulatory policy, which is good for consumers and is simple to put in place.

For more than a decade, the AICPA and the National Association of State Boards of Accountancy (NASBA) have worked to create and refine a model statute, called the Uniform Accountancy Act (UAA), that establishes a comprehensive national regulatory framework.

Although the UAA covers all aspects of the regulation of accountancy in a state, one key innovation has been the concept of "substantial equivalency." A state that adopts substantial equivalency recognizes that an out-of-state CPA can practice in the state if he or she comes from a state with CPA licensure requirements that are substantially equivalent to the rigorous education, experience and examination requirements in the UAA (or individually meets those requirements).

Adopting substantial equivalency will permit all CPAs from substantially equivalent states, and an individual CPA from any state who demonstrates the same level of personal qualifications, to practice within its borders. Broad adoption of substantial equivalency ensures that consumers can retain the CPA of their choice; allows CPAs to respond to the needs of consumers who transact business in multiple states; and frees regulators to focus on other enforcement priorities.

Over time, however, the effort by the AICPA and NASBA to promote mobility through substantial equivalency policies has become compromised by burdensome notification rules—requiring out-of-state CPAs to complete lengthy forms or seek official approval prior to entering a state to provide accounting services. In many states, CPAs who provide necessary services for companies with operations in multiple states are forced to wait for forms to be processed. These arcane notification rules do not assist businesses or consumers in search of the best available professional services from CPAs.

Recognizing that the benefits of substantial equivalency had been undercut by patchwork notice requirements, the AICPA and NASBA developed amendments to the UAA that eliminate these outdated notification requirements for CPAs who wish to provide certain accounting services. Arizona, Colorado, Connecticut, Delaware, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, Ohio, Rhode Island, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, West Virginia and Wisconsin have already adopted a uniform change to their law. Additionally, Georgia, Oklahoma and Pennsylvania have enacted legislation that provides for mobility practice privileges for CPAs from states that have passed mobility. At least

Arcane notification rules do not assist businesses or consumers in search of the best available professional services from CPAs.

15 states have indicated that they will consider mobility legislation in the 2009–2010 sessions.

Regulators' ability to discipline out-of-state CPAs is not dependent on notification, and eliminating the notice requirement will not harm states' ability to oversee out-of-state CPAs practicing within their borders. The amended UAA provides that individual CPAs licensed in one state who enter another state to practice pursuant to the substantial equivalency practice privilege *automatically* consent to the disciplinary authority of the second state's accountancy board and to comply with that state's accounting statutes and board regulations. If an out-of-state accountant must be disciplined by regulators or the courts, the amended UAA has given the states expansive disciplinary authority—and guaranteed jurisdiction to exercise it. This automatic jurisdiction over out-of-state CPAs the UAA provides is bolstered by the fact that state courts have traditionally exercised jurisdiction over professionals, including attorneys, who enjoy the privilege of practicing within the state. State courts that have considered the question have regarded jurisdiction over out-of-state accountants the same way. Our offices will work with the proper authorities to pursue any person who enters our state and violates the law, and eliminating a notice requirement that generates needless paperwork will not impact our ability to protect consumers.

We also believe that eliminating the notification requirement would increase regulators' ability to enforce high standards for the practice of accounting and thereby protect the public. Currently, regulators are forced to process the notifications submitted by out-of-state CPAs, shifting time and resources away from enforcement and oversight, and focusing on the essentially bureaucratic task of administering notification systems. Less time spent on paper-pushing means more time devoted to actually protecting the public.

Therefore, the amended UAA simultaneously helps consumers by eliminating barriers to the free choice of accounting professionals, while also offering regulators a powerful tool to oversee the practice of accounting in their state. CPAs' clients will no longer be limited by varied state licensing and notification regimes, and state regulators will be sure that they possess jurisdiction and disciplinary authority over out-of-state CPAs. In the fast-moving and diverse modern economy, we believe that implementing a regulatory approach that allows freedom of choice in accountants—and is coupled with tough oversight by state accountancy boards—is the best choice for everyone. ❖

***Patrick C. Lynch** is attorney general of Rhode Island, and **Bob McDonnell** is attorney general of Virginia.*

Tax Treatment of Rebates May Be Clearing Up

Here's how to manage these payments' tax recognition.

by Larry Maples

Rebates are used in many vendor market channel programs to accomplish objectives such as jump-starting a market, overcoming market barriers and supporting a market until economies of scale can reduce production costs. The income tax treatment of rebates, however, has been a simmering dispute for more than 50 years, leaving uncertainty for both payers and recipients as to characterization and timing.

Recently, the IRS has taken steps to reduce some of the confusion. But a major issue remains unsettled: whether a rebate is a sales price adjustment reducing gross income (exclusion) or a deduction from gross income. This would be a distinction without a difference for federal taxable income, which is reduced either way, except that a deduction is subject to the restrictions of IRC § 162(c) (state sales taxes could also be affected). Thus, rebates that have not qualified as exclusions have been disallowed altogether when the IRS held them to be not ordinary and necessary, or when the payment fit one of the prohibited categories of section 162(c), such as illegal payments or kickbacks.

The rapidly evolving position of the IRS can be viewed through the prism of a series of pronouncements on Medicaid rebates paid by drug manufacturers. In FSA 200101004, the IRS advised that such rebates paid to state agencies were not sales price adjustments. Then in Revenue Ruling 2005-28 and, more recently, in Revenue Ruling 2008-26, the IRS reversed that position using the identical fact pattern. This reversal should not be narrowly interpreted to apply only to Medicaid rebates, because in these more recent rulings the IRS also announced it was suspending an earlier ruling (Revenue Ruling 76-96—see below) that had held that rebates paid by automobile manufacturers were business expenses.

A dictionary definition of a rebate is "a return of a part of a payment." This basic

nonlegal definition implies that payment is returned from seller to buyer. Through the years, the IRS has resisted exclusion treatment for payments that do not literally match this definition, that is, payments not made to the buyer or payments made by non-sellers. The IRS has argued that the intent of such payments cannot be to reach an agreed-upon net selling price because the payment is not between the buyer and seller.

Taxpayers have had a good deal of success in the courts arguing for exclusion treatment for direct payments from seller to buyer. Payments to third parties have been closely scrutinized, but the IRS is currently opening the door. However, neither the courts nor the IRS has allowed exclusion treatment for "rebates" paid by a non-seller.

Open Door on Seller-to-Buyer Payments

The *Pittsburgh Milk* (26 TC 707) case first established in 1956 that direct seller-to-buyer rebates were excludable from gross income. In that case, a dairy wholesaler paid cash rebates to buyers under an informal arrangement to avoid state minimum milk price regulations. The Tax Court held that despite their illegality, the rebates were exclusions because the purpose was to adjust the gross price to a previously agreed net price, and thus the amounts rebated were really only held temporarily as deposits.

The IRS at first declined to acquiesce, but after losing several similar cases agreed not to disagree. But when the prohibitions against deducting certain illegal payments and kickbacks were inserted into the Code, the Treasury issued regulations attempting to also apply that rule to exclusions. The IRS also in 1976, in anticipation of litigation in a similar case involving wholesale liquor, renewed its nonacquiescence to *Pittsburgh Milk*. These efforts to circumvent the *Pittsburgh Milk* precedent were defeated in the liquor case, *Max Sobel v. Commissioner* (69 TC 477, *aff'd* 46 AFTR2d 80-5799 (9th Cir. 1980)). There, a wholesale liquor dealer violated state minimum pricing regulations by giving a free bottle or credit for each case purchased. The courts held the restrictions on illegal payments applied only to deductions and invalidated the application to exclusions. Although the regulations were not withdrawn, the IRS then once more acquiesced in *Pittsburgh Milk* and now *Max Sobel* and issued a revenue ruling (82-149) holding that illegal rebates paid directly from seller to purchaser are adjustments to the sales price.

Although the IRS conceded the issue on illegal payments, it has continued to monitor seller-to-buyer payments that do not appear to arrive at a specific net selling price. In *Foretravel Inc. v. Commissioner* (TC Memo 1995-494), the IRS argued unsuccessfully that incentive rebates by a mobile home manufacturer to its dealers were not sales price reductions because the rebate policy could not be reduced to a numerical formula. In the *SunMicrosystems* (TC Memo 1993-467) and *Convergent Technologies* (TC Memo 1995-320) cases, computer workstation manufacturers issued stock warrants as buying incentives. Customers sold the warrants to underwriters to reduce the cost of the workstations. The IRS objected to treating the warrants as purchase price adjustments because there was no agreed net price at the time the seller and buyer entered into the agreements. But the Tax Court treated the warrants as exclusions, reasoning that the absence of an advance fixed net price was not crucial, since the agreements provided a mechanism for determining a future price.

> Neither the courts nor the IRS has allowed exclusion treatment for "rebates" paid by a non-seller.

Thus, for more than 50 years, the courts have held the door open to exclusion treatment for seller-to-buyer rebates despite repeated IRS attempts to develop a rationale for deduction treatment. It even appears that the original *Pittsburgh Milk* criterion of an agreed-in-advance net sales price has been expanded in the stock warrant cases.

In Chief Counsel Advice 200834019 (8/22/2008), a taxpayer's attempt to use the recurring-item exception under IRC § 461(h)(3) to accrue the rebate at sale was denied. To qualify for the rebate, the customer must fill out a form, attach certain items and mail them to a third-party administrator within 30 days. The qualifying customer normally receives a check several months later. The IRS, citing the Supreme Court's decision in *General Dynamics* (481

EXECUTIVE SUMMARY

- **The IRS has attempted for many years to categorize rebates** as deductions rather than exclusions so that the restrictions of IRC § 162 can be applied. But the courts have allowed exclusion treatment for direct seller-to-buyer rebates.
- **Though the IRS has had some success in the courts** challenging rebates to third parties, recent rulings indicate it is pulling back and may be willing to allow exclusion treatment.
- **The IRS and the courts agree** that rebates paid by non-sellers are not excludable, reasoning that only the seller can agree to a price adjustment.
- **Although the IRS appears to be moving toward** allowing most seller-paid rebates as exclusions, it is now insisting that even accrual taxpayers delay the exclusion until the rebate is paid.

Larry Maples, CPA (inactive), DBA, is a professor of accounting at Tennessee State University in Nashville, Tenn. His e-mail address is lmaples@tnstate.edu.

U.S. 239 (1987)), said the taxpayer's liability for rebates is not fixed until the customer mails the form and attachments.

Door Cracked on Third-Party Payments

Until the recent rulings, neither the IRS nor the courts have been willing to allow exclusion treatment for payments to third parties. The most quoted case is *United Draperies* (41 TC 457, *aff'd* 15 AFTR2d 50.1 (7th Cir. 1964)), in which a manufacturer paid rebates to employees of its purchasers based on a percentage of collections from those purchasers. The Tax Court said the kickbacks were not exclusions because the payments were for the referral service provided and were independent of the price agreement between the seller and buyer. On appeal, the Seventh Circuit agreed and pointed out that the seller had a claim of right to the entire sales price.

The IRS applied *United Draperies* to deny exclusion treatment of rebates from automobile manufacturers to buyers in Revenue Ruling 76-96. The reasoning was that the price was negotiated between the *dealer* and the customer. Since the manufacturer's rebate was independent of the price negotiated between the dealer and buyer, the IRS held it could not be an exclusion for the manufacturer. Although this ruling was consistent with *United Draperies*, the IRS in Revenue Ruling 2005-28 suspended it. This is very interesting because the IRS normally is reluctant to give up a position it has won in the courts. Apparently, the IRS is concerned about consistency in the treatment of taxpayers. The change in position on Medicaid rebates, which also involve payments to third parties, is causing the IRS to reconsider at least automobile rebates and perhaps third-party rebates in general.

In the Medicaid rulings (2005-28 and 2008-26), the IRS set up *Pittsburgh Milk* as the standard. Thus, rebated amounts that were intended to reduce a list price to an agreed net price should be treated as exclusions. The fact that the rebate is paid to a third party (the state Medicaid agency) is not crucial so long as the purpose and intent is that the rebate is "a factor used in setting the actual selling price." The existence of the Medicaid rebate agreement guaranteed that the rebate would be a factor.

> Rebated amounts that were intended to reduce a list price to an agreed net price should be treated as exclusions.

Questions and Concerns

Taxpayers paying rebates to third parties have received some good news in the recent rulings. However, there are some unresolved issues. Despite using *Pittsburgh Milk* as the standard, the rulings do not touch on the fact that the case concerned illegal rebates, whereas the rulings discuss only legal rebates. Will the IRS be willing to stick with the *Pittsburgh Milk* rationale when illegal rebates are involved? The rulings do not mention Treas. Reg. § 1.61-3(a), which denies exclusion treatment if such payments would be nondeductible under IRC § 162(c) (illegal payments and kickbacks). Although the *Max Sobel* line of cases would seem to invalidate that regulation, does the refusal of the IRS to withdraw that regulation mean the Service is not finished with this issue?

The other concern is timing. The IRS has opened the door for exclusion treatment, at least for legal rebates. But what if the rebate is paid in the year following the sale? Will the IRS allow the rebate to be matched with the sale? In this respect, the language of Revenue Ruling 2008-26 should be closely compared with its nearly identical predecessor, Revenue Ruling 2005-28. The facts and analysis are the same, but when the latest ruling states the timing rule, it replaces the word "incurred" with "paid." Thus, the IRS will not allow a match of the rebate with the associated sale. The deduction is not allowed until payment.

This change of language apparently signals the IRS's intent to apply the economic performance requirement of IRC § 461(h) to rebates treated as exclusions. Treas. Reg. § 1.461-4(g)(3) provides that economic performance to pay a rebate occurs only on payment unless the recurring-item exception applies. Despite criticism from commentators who believe it is inappropriate to apply the economic performance rule to exclusions, this latest language change demonstrates the renewed resolve of the IRS. The IRS has the latitude to require payers to wait for a deduction until the rebate is paid because the fountainhead case, *Pittsburgh Milk*, did not address the issue of payments made after the year of sale. But the net-selling-price rationale of that case would be better served with a simple matching rule.

In a letter ruling (200826006) issued a month or so after Revenue Ruling 2008-26, the IRS explicitly applied the economic performance cash payment rule to rebates. An accrual-method retailer reduced gross receipts by the amount of its estimated rebate payment, which meant that at year-end, unpaid rebates had been used to reduce income. The IRS ruled that the retailer must wait until payment to reduce income and stated, "….subparagraph (g)(3) [of Reg. 1.461-4] applies to *all* rebates, refunds and payments or transfers in the nature of a rebate or refund regardless of whether they are characterized as a deduction from gross

AICPA RESOURCES

***JofA* article**
"Pay Now or Defer," Nov. 05, page 91

Tax Section
The Tax Section provides tools, technologies and peer interaction to CPAs with tax practices. The Section keeps members up to date on tax legislative and regulatory developments. More than 23,000 CPAs are Tax Section members. Visit the Tax Center at **http://tax.aicpa.org**.

income, an adjustment to gross receipts or total sales, or an adjustment or addition to costs of goods sold."

Closed Door on Non-Seller Payments

The courts have generally not allowed a non-seller to exclude a rebate, reasoning that only the seller can agree to a price adjustment. There is a line of cases on insurance agents who had agreed to give certain customers illegal discounts/rebates to induce them to purchase policies. The Tax Court initially allowed an agent to exclude such payments, reasoning he never had a claim of right to a full commission he had partially bargained away. But beginning with its decision in *James Alex v. Commissioner* (70 TC 322 (1978), *aff'd* 46 AFTR2d 80-5802 (9th Cir. 1980)), the Tax Court has said such payments are not excludable because an agent is the agent of the seller and cannot make a price adjustment without the seller's authority. The Ninth Circuit agreed, adding that only a seller can qualify for exclusion treatment under *Pittsburgh Milk*. These decisions are doubly bad news for non-sellers because not only are the payments not exclusions, they also are not deductions under IRC § 162(c)(2). But not all non-seller rebates are illegal. In *Robert E. Corrigan v. Commissioner* (TC Memo 2005-119), the Tax Court did not allow a stockbroker who rebated part of his commission to a customer to exclude it from income. But the court allowed an employee business expense deduction because the payments were not illegal.

Taxpayers could have success under the claim-of-right doctrine if they actually contract away their right to receive a portion of a commission. The Tenth Circuit in *Mickey L. Worden v. Commissioner* (72 AFTR2d 93-5998) reversed the Tax Court, allowing an exclusion to an insurance agent whose contract with an insurance company allowed him to remit only the net premium and whose contracts with clients allowed him to collect only the net premium.

Stay Tuned

CPAs should closely monitor at least three aspects of future IRS guidance:

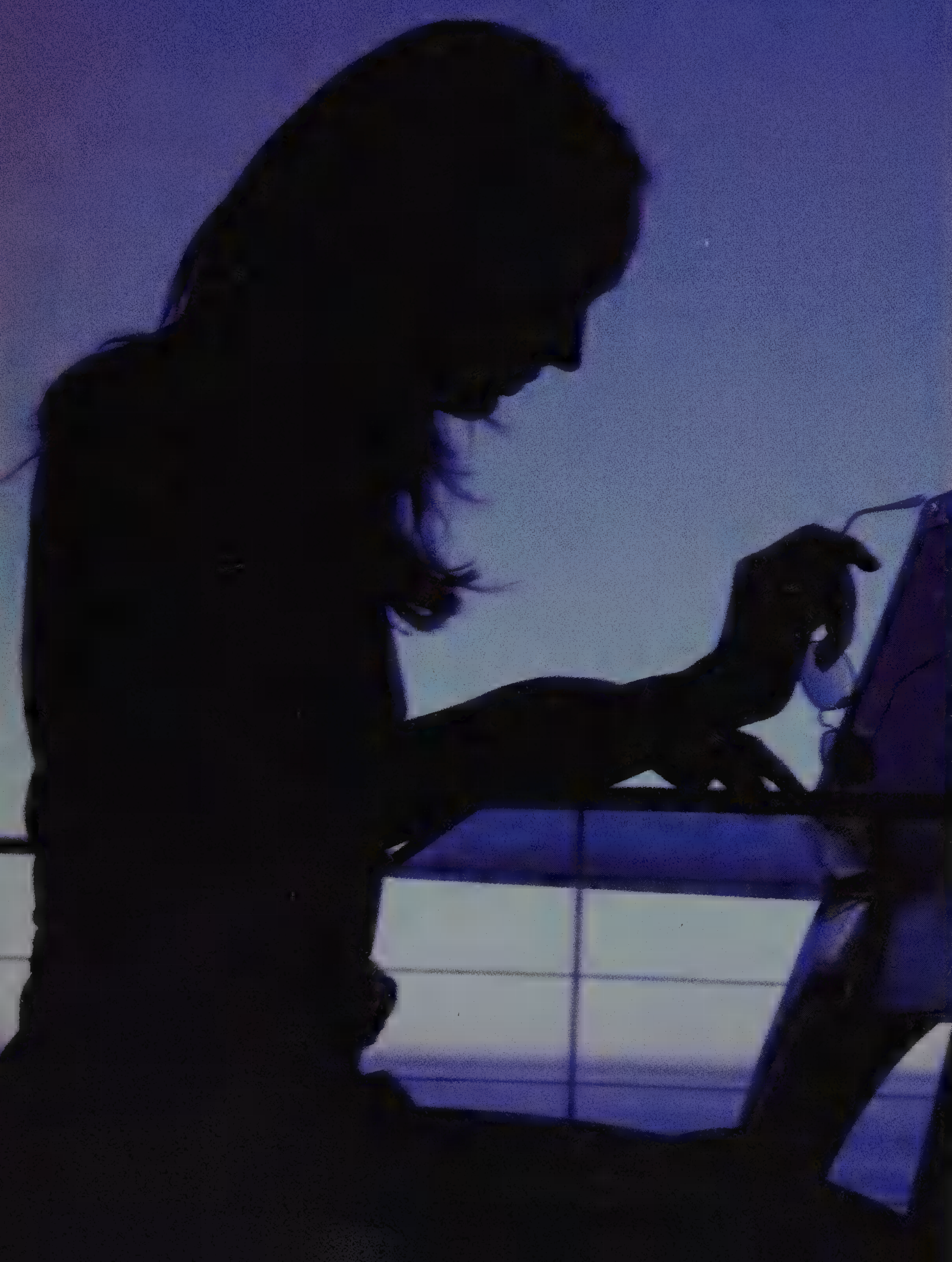
1. Will the IRS follow through on the suspension of Revenue Ruling 76-96 by reversing that ruling? Will it apply the principles of the recent Medicaid ruling more broadly?
2. Will the IRS stick to its guns and force payers to delay exclusions until the rebate is paid, that is, apply the economic performance standard to rebates? If so, this controversial position could spawn a court test.
3. Will the IRS apply the exclusion rule of Revenue Ruling 2008-26 to illegal payments? The focus on *Pittsburgh Milk* in that ruling would seem to imply that the answer is "yes." But the only examples in that ruling are legal payments. ❖

Welcome to the new world

A Showcase of Tax Research

Survey of taxation analysis carries potential insights for practitioners.

by Cynthia Bolt-Lee and Elizabeth Plummer



In this third installment of "In Practice," we distill research published in tax and accounting journals that should be of interest to busy tax practitioners. The pervasiveness of tax considerations in the affairs of everyone from students to CEOs makes the field a particularly fertile one for studying financial behavior. Authors of the following research have derived findings that carry implications for tax practitioners and those using professional tax services. Their work has been published in *Accounting Horizons*, *Contemporary Accounting Research*, *Journal of the American Taxation Association*, *The ATA Journal of Legal Tax Research* and the *National Tax Journal*.

Aggressive Tax Positions and the Expectations Gap

Professional tax preparers perform services for their clients that are generally more aggressive than their clients prefer, according to research. Studies of "client advocacy" measure the expectations of service from the tax professionals' and the taxpayers' perspectives. Research shows that while tax preparers assume their clients prefer more aggressive positions, clients actually prefer reduced risk. Prior research was conducted with large firms, although more than half of all returns are prepared by self-employed, local or regional firms, including non-CPAs and non-enrolled preparers.

Author Teresa Stephenson's research surveyed more than 500 tax preparers in 2005 to determine the difference between tax preparers' perspective of what their clients wanted and the clients' actual expectations. The sample consisted of non-Big Four firms and included small CPA firms and non-CPAs. The December 2007 article published in *Accounting Horizons* ("Do Clients Share Preparers' Self-Assessment of the Extent to Which They Advo-

cate for Their Clients?") supports prior research in this area showing taxpayers prefer less-aggressive preparers. The author's survey reveals the misperceptions between preparer and taxpayer. This discrepancy is found regardless of whether a CPA or non-CPA prepares the return.

The research provides a further understanding of the miscommunications between professional tax preparers and their clients. Stephenson's study suggests that clients not only misunderstand their tax preparer's intentions but that taxpayers generally prefer a more conservative approach than that perceived by preparers. In light of these findings, tax preparers and advisers may want to review their communication procedures, particularly how they discuss with their clients matters of risk preferences and tolerance.

Should Older Employees Continue Working or Retire?

As the baby boomers reach retirement age, concerns over the adequacy of Social Security, health care and other benefits have led policymakers to consider incentives to encourage workers to remain in the work force. Prior research shows employees will choose retirement if they believe they will lose benefits by remaining employed. However, delayed retirement enhances not only employees' current income and benefits in areas such as health care and future Social Security but also adds to economic productivity in the U.S. This in turn increases income tax and Social Security revenue.

Barbara Butrica, Richard Johnson, Karen Smith and Eugene Steuerle analyzed the combined impact of factors that encourage retirement—and discourage working—by calculating an "implicit tax rate" on workers who remain employed after age 55. Costs of staying in the work force include income tax and Social Security withholdings, lost benefits, reduced Social Security and Medicare benefits, and the deferral of pension benefits.

The authors measured the implicit tax rate associated with an additional year of employment at various ages, marital statuses and life expectancies. Results reveal an increasing implicit tax rate as workers age, ranging from approximately 14% at age 55 to 50% at age 70.

The research, published in the June 2006 *National Tax Journal,* is titled "The Implicit Tax on Work at Older Ages." The study suggests that tax policy that encourages work and discourages retirement will increase economic productivity, generate additional tax revenue and reduce the increasing tax burden created by an aging population.

One study shows that taxpayers generally prefer a more conservative approach than that perceived by preparers.

Bigger Refunds Correlate With Higher Preparation Fees

Authors Scott Jackson, Paul Shoemaker, John Barrick and Greg Burton studied the relationship between tax return preparation fees and taxpayers' prepayment position on their completed return of either a refund or an amount due. Prior research shows that despite the interest-free loan received by the government due to overpayment of estimates, taxpayers prefer a refund. This occurs whether the tax return is prepared by a professional or not. Furthermore, evidence shows that refunds have increased in recent years.

The current research, building on prior studies, analyzed taxpayers' motivation to overpay beyond the safe harbor amounts, particularly when returns are professionally prepared. Their work, drawing on "mental accounting theory," examines taxpayers' "favorable mental representation" of tax preparation fees when taxpayers are in a refund position, which in turn is shown to allow tax preparers to charge and collect more of their billable time.

The authors analyzed IRS data for more than 68,000 taxpayers to test their theory. Their findings, supported by strong statistical analysis, indicate a very clear relationship between tax preparation fees and taxpayers who receive refunds, versus taxpayers with a balance due on their return. The relationship holds true for tax preparation fees that are greater or less than the taxpayer's refund. The study found that large taxpayer refunds generally result in a proportionally larger tax preparation fee. Conversely, proportionally lower fees occur with lower tax refunds or amounts due.

The authors note that their research cannot determine the intent or perceptions of either the taxpayer or tax preparer. Nonetheless, it suggests overpayment of estimated tax might not be detrimental to client satisfaction and may in many cases increase it. The work, titled "Taxpayers' Prepayment Positions and Tax Return Preparation Fees," appeared in the Summer 2005 issue of *Contemporary Accounting Research*.

Practitioners' Moral Majority

Tax professionals face unique ethical challenges in their role as both an advocate for the client and in their responsibility for compliance with the law. This dual role emphasizes the need for a strong ethical environment within the firm. This can best be achieved through in-house ethics training and a performance evaluation process that offers incentives for ethical behavior and penalizes lapses, according to "An Experiential Investigation of Tax Professionals' Ethical Environments." Authors Donna Bobek and Robin Radtke studied the tax professionals' ethical environment, analyzing the relationship between practitioners' view of their firms' ethical environment and the ethical dilemmas encountered in practice.

Ratings of ethical environments were very strong overall, and participants in the survey indicated an enhanced focus on firm ethics in recent years. Eighty-six of the 146 survey participants stated they had faced

a specific ethical dilemma at their firms. These participants faced ethical issues involving client pressure, client retention, time constraints, difficulty determining the accuracy of certain client information, and a perception that the client had acted in an unethical manner. Factors contributing to the resolution of these ethical dilemmas were described as professional experience, communication and personal ethical beliefs, although internal firm training was shown to assist as well.

The relationship between ethical dilemmas and the professionals' perception of their ethical environment reveals the importance of an effective firm culture focused on appropriate social norms, awareness and training. Persons rating their firms' ethical environment as strong typically described encountering fewer ethical dilemmas. Persons who rated their environment as strong and who had faced an ethical dilemma perceived their situation as more serious than those who had faced an ethical dilemma but rated their firm's ethical environment lower. This suggests an enhanced awareness is created by firms with a strong ethical environment. Researchers suggest that individuals in firms with a strong ethical environment are also better equipped with tools for improved resolution of problems.

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The research, appearing in the Fall 2007 *Journal of the American Taxation Association*, reinforces the argument that in-house ethics training and an enforceable ethics code, as well as the reinforcement of "strong social norms" for the individual, co-worker and management, encourage a stronger ethical environment.

Is Unrelated Business Income Underreported?

Nonprofits are subject to the unrelated business income tax (UBIT) on income earned from business activities that are unrelated to a nonprofit's tax-exempt purpose. The UBIT's primary purpose is not to raise revenues, but rather to make sure nonprofits don't have an unfair competitive advantage over a taxable entity. Prior research suggests that nonprofits try to reduce their UBIT liability by shifting expenses from their tax-exempt activities to their taxable activities. Shifting expenses would increase nontaxable income and decrease taxable income.

In general, the tax laws governing expense allocation methods for nonprofits are relatively broad, with the primary requirement that the method be reasonable and consistently applied. For some taxable activities, however, compliance rules mechanically limit the amount of expenses that can be reported. Expense amounts exceeding this limit would indicate that a nonprofit overstated its expenses and thus incorrectly understated taxable income.

Authors Thomas Omer and Robert Yetman used a confidential set of nonprofit tax returns (Form 990-T) to determine whether nonprofits in the sample misreported their expenses and, if so, by how much. The authors found that 19% of the nonprofits in the sample reported more expenses on their Form 990-T than was allowed under existing tax law, and the average overstatement was 30% of reported expenses. Although the authors documented that nonprofits misreport expenses, they were unable to determine whether this misreporting was intentional (tax evasion) or unintentional (random errors).

The authors examined the factors that affect nonprofits' misreporting of expenses. They found that nonprofits are more likely to misreport expenses when tax rates are higher, when a nonprofit's tax return is more complex, and when a nonprofit's taxable and tax-exempt activities are more likely to share common expenses. The authors also found that misreporting is lower when a nonprofit faces increased reporting to state agencies. Additional reporting requirements increase the probability that errors will be detected, making it less likely that nonprofits will misreport. The magnitude of this study's results suggests that relatively modest changes in tax rates and reporting requirements, plus accounting system flexibility, can have large effects on nonprofits' tax avoidance behavior. The study, titled "Tax Misreporting and Avoidance by Nonprofit Organizations," was published in the Spring 2007 issue of the *Journal of the American Taxation Association*.

Personal Use of Corporate Aircraft Examined

Personal use of company-owned aircraft by company executives increased significantly in the past decade. This resulted in increased congressional and IRS scrutiny of the tax treatment of these activities. A paper by Karen Miller, Riley Shaw and Tonya Flesher ("Taxation of Personal Use of Corporate Aircraft: Should Income Equal the Deduction?") tracked changes in the tax law regarding the personal use of corporate aircraft. The authors addressed three questions: What amount should be included as compensation by the employee for the personal use of the company's aircraft? How much should the employer deduct for the operating cost related to the personal use? Should these amounts be equal?

The American Jobs Creation Act of 2004 (AJCA) substantially changed the tax treatment of the costs associated with the personal use of corporate-owned aircraft. The authors began by discussing the legislative and judicial history that preceded these changes. Prior to the AJCA, court decisions allowed companies to deduct the full operating costs incurred to operate business aircraft if the employee reported the value of personal use as compensation. Compensation was generally calculated using the Standard Industry Fare Level (SIFL) rates, which could result in income amounts that were substantially less than

the corporation's deductions. The AJCA's provisions disallow deducting the costs of personal use of business aircraft by "specified individuals" to the extent these costs exceed the corresponding compensation amount. Specified individuals include officers, directors, and greater than 10% owners of a corporation. However, the tax treatment for non-specified individuals did not change, potentially resulting in inequitable tax treatment.

Congress continues to debate the deductibility of personal use of company aircraft, and the authors focused on several recent legislative proposals. One of these provisions would require employees to recognize income based on the actual cost of using the aircraft, and companies would be allowed a full deduction for the actual cost. The authors argued that this treatment taxes the transaction more consistently with its economic reality and increases fairness. Under current law, private citizens incur taxes on all their income used to purchase personal flights, while executives using corporate aircraft only incur taxes on a portion of the actual costs of their flights. Taxing executives on actual cost more nearly treats them as private citizens. This type of proposal might discourage the personal use of corporate aircraft, which would benefit company shareholders by decreasing their subsidy of executives' personal travel. This paper appeared in *The ATA Journal of Legal Tax Research* (October 2007).

> Understanding NOL usage is especially important as policymakers consider ways to stimulate economic growth.

Knowing More About NOLs

Corporate income tax systems treat losses differently than income. While positive taxable income is immediately taxable, net losses must be carried back to receive an immediate refund of taxes paid in prior years, or carried forward to offset future tax payments. Carrying a loss forward can decrease the loss's real value because the tax benefits are not realized until a future date. In the extreme case, a loss will have no value if it is carried forward but never used.

Corporate tax losses are widespread. For tax years 1993 through 2003, approximately 2.1 million companies filed a corporate income tax return each year. Between 43% and 51% of firms reported a loss, and the average reported loss ranged from $100,000 to $400,000. Most companies could not use their full loss as a carryback.

To better understand how quickly corporations are able to use tax losses, authors Michael Cooper and Matthew Knittel examined a large sample of corporate tax returns for the period. Both authors are members of the Office of Tax Analysis, Department of Treasury, with access to tax return data. The sample included approximately 46,000 to 68,000 companies each year. Loss companies constituted 30% to 40% of the sample, with the average loss ranging from $5 million to $14 million.

For most tax years, the authors found that approximately 10% to 15% of losses are carried back for an immediate refund. About 40% to 50% of losses were used as a carryforward deduction within 10 years of the initial loss year, but in many cases only after a substantial delay. An additional 10% to 20% of losses remained unused at the end of the 10-year carryforward period the authors examined, and approximately 25% to 30% of NOLs were never used.

Large amounts of NOLs were generated in recent years (2000 to 2003) and remained unused as of 2003. These loss companies were generally members of industries that are cyclical, overinvested or characterized by high fixed costs. Even if these corporations become profitable again, the authors believe it will be many years before these companies can generate ❯

sufficient taxable income to use such large NOL carryforward amounts. Differences in NOL usage can help explain why certain industries respond less to tax incentives, such as accelerated depreciation. Understanding NOL usage is especially important as policymakers consider ways to stimulate economic growth.

This study, "Partial Loss Refundability: How Are Corporate Tax Losses Used?" appeared in the September 2006 issue of the *National Tax Journal*.

The Effect of FIN 48 on Tax Reserves

FASB Interpretation no. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, is intended to standardize accounting for uncertain tax positions by providing recognition and measurement rules and, where applicable, by requiring companies to disclose the amounts of their tax reserves. The reserve represents the firm's estimate of additional tax expense the firm expects to owe if the position is challenged by the taxing authorities and after all litigation is resolved.

How will FIN 48 affect the tax reserve amounts reported on companies' financial statements? Are businesses adjusting their reserve amounts prior to adopting FIN 48? To help answer these questions, authors Jennifer Blouin, Cristi Gleason, Lillian Mills and Stephanie Sikes summarized tax-related financial statement disclosures before and after adoption of FIN 48. Their sample consisted of the 100 largest and the 100 smallest nonregulated and nonfinancial public companies with a calendar year-end, covered by at least five analysts on the Institutional Brokers Estimate System.

The authors argued that companies have incentives to reduce their reserve amounts prior to adopting FIN 48. Large tax reserves could be used by the IRS as a signal of tax aggressiveness, thereby increasing the chances of audit. The authors anticipated that large companies were more likely than small ones to reduce tax reserves in the years preceding FIN 48. This is because large enterprises are subject to continual audit by the IRS and are more likely than small ones to have excess reserves.

As expected, the authors found that decreases in reserves prior to FIN 48 were more frequent for large companies compared with small ones. For the largest 100 companies, the authors found that decreases in reserves were more frequent in 2006 than in 2005 but were not larger in amount. For small companies, there was no difference between 2005 and 2006 in the frequency or amount of changes in reserve amounts.

> The authors found that decreases in reserves prior to FIN 48 were more frequent for large companies compared with small ones.

For the largest 100 companies, the unrecognized tax benefit on Jan. 1, 2007, (the adoption date of FIN 48) was $78 billion, excluding accrued interest and penalties. This equaled approximately 2% of total company assets. There were significant differences across enterprises in the size of their reserves. Several businesses' reserves exceeded $5 billion and in some cases exceeded 5% of total assets.

Of the $78 billion, companies disclosed that $58 billion would increase earnings if the uncertainty were resolved in the taxpayer's favor. The $20 billion difference is likely related to temporary differences or valuation issues related to mergers and acquisitions. These amounts would result in balance sheet reclassifications or equity adjustments. Accrued interest and penalties were potentially about $13 billion.

Disclosures for the 100 small companies told a very different story. Only five of the 100 small companies decreased reserves upon adopting FIN 48. Small companies were more likely to increase reserves (39 companies) or not change reserves (56 companies).

Of importance to both financial accounting and tax practitioners, the authors found inconsistencies across companies' FIN 48 financial disclosures. For example, it is often unclear whether the gross reserve for unrecognized tax benefits includes or excludes accrued interest payable. It is also unclear whether the disclosure of the reserve amount that would affect earnings includes or excludes interest expense. Although the authors remain optimistic that future disclosures will increase in clarity and comparability, they note that guidance on best practices would help clarify and improve FIN 48 reporting. FASB, the SEC, the Big Four and other auditing firms can all play an important role in providing guidance. This study, titled "What Can We Learn About Uncertain Tax Benefits From FIN 48?" was published in the September 2007 issue of the *National Tax Journal*.

The full text of each article describes these studies in detail for those interested in specifics related to the research process. ❖

***Cynthia Bolt-Lee**, CPA, M. Taxation, is an associate professor at The Citadel School of Business Administration in Charleston, S.C. **Elizabeth Plummer**, CPA, Ph.D., is an associate professor of accounting at the Neeley School of Business at Texas Christian University in Fort Worth, Texas. Their e-mail addresses, respectively, are cynthia.bolt@citadel.edu and c.e.plummer@tcu.edu.*

AICPA RESOURCES

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Derivatives and Hedging: Accounting vs. Taxation

Ballast for stormy financial seas

by Robert Bloom and William J. Cenker

A derivative is a financial instrument that derives its value based on its relationship to another financial instrument such as a stock or bond, to an index or to an exchange rate.

With derivatives, mutual funds manage risk in their portfolios. Banks use them to guard against losses. Oil companies use them to hedge against or counteract the prospect of future price changes. Airlines use them to try to lock in more favorable fuel prices. And above all on our shrinking planet, cross-border transactions depend upon them to ameliorate the risk of currency exchange rate fluctuations. Because derivatives used in hedging are more likely than ever to crop up in companies' financial statements, CPAs need to be conversant in the accounting requirements for them and especially how to manage the temporary differences between financial accounting and tax reporting.

This article focuses on two types of derivatives—options and forward contracts. Options are rights to engage in futures contracts, which are contracts to exchange goods of a particular quantity at a designated price and date. Forward contracts are the same as future contracts but are not regulated by organized exchanges. Whereas in accounting, derivatives are marked to market, that is not the case in income taxation. CPAs should be familiar not only with the accounting requirements of derivatives but also the income tax regulations governing them, since the differing treatments produce deferred tax consequences. This article contrasts gains and losses using those derivatives and in so doing reconciles the accounting and tax differences in deferred tax accounts.

Accounting Treatment

Financial accounting for derivatives takes a fair value approach. The gain or loss on

the derivative generally offsets the loss or gain on the risk exposure. The accounting treatment depends on whether it qualifies as a hedging instrument and, if so, on the designated reason for holding it (FASB Statement no. 133, *Accounting for Derivative Instruments and Hedging Activities*, paragraph 18).

a. ***No hedging designation.*** The gain or loss on a derivative instrument not designated a hedging instrument appears in current income.
b. ***Fair value hedge.*** This is a hedge of the fair value of an asset or liability in a purchase, sale transaction or firm commitment at a definite price. The gain or loss on a fair value derivative as well as the offsetting loss or gain on the hedged item appear in current earnings in the same period.
c. ***Cash flow hedge.*** This hedge is concerned with variable cash flows stemming from forecasted transactions or cash flows from assets and liabilities already incurred.

Effectiveness in hedging is the degree to which the value change in a hedge offsets the value change in what is being hedged—such as using a forward contract to offset exchange rate fluctuations in the euro on a sale of inventory in that currency to a foreign buyer. The effective portion of the gain or loss on a cash flow derivative is a component of other comprehensive income and reclassified to income in the same period or periods in which the hedged forecasted transaction affects income. Any remaining gain or loss on the derivative appears in current income.

The types and uses of derivatives are as varied as the number of financial instruments in which a company may invest. While the accounting for all derivatives follows the above general rules, this discussion considers derivatives used to manage the risk of currency fluctuations on transactions denominated in a foreign currency.

Hedge documentation is imperative for financial accounting as well as income taxation.

Foreign currency hedging transactions involve risk management associated with assets and liabilities denominated in a foreign currency. In such events a corporation buys or sells goods with a foreign corporation, and the transaction is to be settled in a foreign currency. With foreign currency firm commitments, a contract agreement to engage in a future foreign currency purchase or sale has occurred—such as a purchase order. With forecasts of foreign currency transactions, predictions of foreign currency transactions are made, but contractual obligations are not incurred. Net investments in foreign operations involve purchases of shares of stock in a foreign corporation. Hence, the "net investment" reflects the equity in this foreign entity (FASB Statement no. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities—an amendment of FASB Statement No. 133*).

An entity may account for assets and liabilities hedges as well as hedges of foreign currency firm commitments either as fair value hedges or as cash flow hedges. Hedges of forecasts of foreign currency transactions may only be accounted for as cash flow hedges (FASB Statement no. 138). An entity reports hedges of net investments in foreign operations in the same way that the hedged translation adjustments are reported (FASB Statement no. 133).

For financial accounting purposes, an entity must use a two-transaction perspective to account for foreign currency transactions: the export sale itself and the extension of credit denominated in a foreign currency (FASB Statement no. 52, *Foreign Currency Translation*). The dollar equivalent of the sale is recorded at the time of sale, and any unrealized foreign exchange gains and losses are accrued in net income in the period in which the exchange rate changes (FASB Statement no. 52, paragraph 124).

Hedge documentation is imperative for financial accounting as well as income taxation. For financial accounting purposes, on the date of the hedge, an entity must

EXECUTIVE SUMMARY

Hedge documentation is important in both financial reporting and income taxation. For financial accounting purposes, on the date of the hedge, an entity must identify the hedged item, the instrument used, the type of risk hedged, the means of assessing hedge effectiveness, and the risk management objective and strategy.

Gains and losses of different types of derivatives for fair value hedges are reflected in the income statement, offsetting losses and gains on transactions being hedged.

Gains and losses on cash flow hedges are "parked" in accumulated other comprehensive income until the transactions occur and then transferred to the income statement to offset the losses and gains on these transactions.

Foreign currency transactions record the dollar equivalent of the sale at the time of sale. Any unrealized foreign exchange gains or losses are accrued in net income during the period in which the exchange rate changes.

Mark-to-market rules do not apply to hedging transactions for tax purposes. An entity must treat an investment in regulated futures or foreign currency contracts that is not a hedging event as though it were sold on the last day of the year for tax purposes.

__Robert Bloom__, Ph.D., is a professor of accountancy at John Carroll University in University Heights, Ohio. His e-mail address is rbloom@jcu.edu. __William J. Cenker__, CPA, Ph.D., was also a professor of accountancy at John Carroll University. He died in March.

identify the hedged item, the instrument used, the type of risk hedged, the means of assessing hedge effectiveness, and the risk management objective and strategy (FASB Statement no. 133).

INCOME TAX TREATMENT

For income taxation, there is an exception to the general requirement for a sale or other disposition to occur prior to gain or loss recognition. An entity treats an investment in regulated futures (that is, future contracts for the exchange of goods, which in contrast to forward contracts are exchange traded) that is not a hedging transaction as if it were sold at its fair market value on the last business day of the taxable year (IRC § 1256(a)(1)). Forty percent of any such gain or loss is treated as short term, 60% as long term (IRC §§ 1256(a)(3)(A) and (B)).

The mark-to-market rules do not, however, apply to hedging transactions, so gains and losses are not recognized on such events (IRC § 1256(e)). In taxation, an entity must clearly identify the hedging transaction as such on the day entered (Treas. Reg. § 1.1221-2(f)(1)). The item hedged must be similarly incurred (Treas. Reg. § 1.1221-2(f)(2)). The time of identification is defined as "contemporaneous," or within 35 days (see Treas. Reg. § 1.1221-2(f)(2)(ii)). Further, for tax purposes such identification must be unambiguous. Identification for financial accounting or regulatory purposes is not sufficient unless the books and records indicate that the identification is also being made for income tax purposes (Treas. Reg. § 1.1221-2(f)(4)(ii)).

A corporation will normally enter into such contracts to hedge a future purchase commitment or to lock in a sales price denominated in a foreign currency. The gain or loss is then ordinary, serving to offset any gain or loss in the underlying contract. Sometimes, a corporation will need to generate a capital gain or loss, so the above hedging rules conceivably may be important for tax planning purposes.

CASE STUDY

Suppose that BC Corp. sells goods with a value of €2 million to Dugas Corp. in France. BC delivers the goods on 11-01-X1. The terms of the agreement require Dugas to pay the euros on 2-01-X2. BC investigates four alternatives with respect to hedging the euro-denominated receivable:

a. Purchase a put option to sell €2 million on 2-01-X2, designating the transaction as a fair value (asset exposure) hedge.
b. Purchase a put option to sell €2 million on 2-01-X2, designating the transaction as a cash flow hedge, or hedge of variable cash flows. As this example will show, a cash flow hedge generates less variable income effects.
c. Enter into a foreign currency forward exchange contract, designating the transaction as a fair value (asset exposure) hedge.
d. Enter into a foreign currency forward exchange contract, designating the transaction as a cash flow hedge.

Exhibit 1 Hedging Alternatives

Date	Spot Rate[1]	Receivable Fair Value	Option Price or Premium[5]	Option Fair Value	Forward Rate[2]	Forward Fair Value
11-01-X1	$1.32	$2,640,000	$0.012	$24,000	$1.30	$ 0.00
12-31-X1	1.35	2,700,000	0.010	20,000	1.33	(59,701)[3]
2-01-X2	1.29	2,580,000	0.030	60,000	1.29	20,000[4]

1. The exchange rate between $ and € for immediate currency conversion.
2. The exchange rate for currency conversion as of a designated future date.
3. € 2,000,000 × ($1.33 − 1.30) = $60,000; $60,000 × 1 ÷ 1.005 = $59,701 (discounted at an assumed annual rate of 6% for one month until payment on 2-01-X2).
4. € 2,000,000 × ($1.30 − 1.29).
5. Assumed to have been determined by Black-Scholes option pricing model. An option price or premium is an initial amount to purchase the option.

Exhibit 1 summarizes financial information with respect to the €2 million receivable and the various alternatives. See the spreadsheet with the online version of this article at **www.journalofaccountancy.com** for illustrations of necessary journal entries.

Put option—fair value hedge. On the date of sale, BC Corp. prepares the journal entry for the foreign-currency denominated sale, assuming a periodic inventory system and the purchase of the option. If BC Corp. were to satisfy the criteria for hedge accounting and account for the purchase of the put option as a fair value hedge, it would adjust the carrying value of the receivable and put option to fair values at the balance sheet dates and recognize such adjustments to income. Assuming the option is a hedge for tax purposes, BC would not recognize as income (loss) the adjustment to the fair value of the option or the receivable at 12-31-X1. Accordingly, a temporary difference between accounting and income taxation occurs, having deferred tax consequences, at an assumed tax rate of 35%.

At 2-01-X2, BC adjusts the receivable and option to their current values, collects the receivable, and exercises the option. For financial accounting purposes, BC recognized income of $56,000 in X1 and a net loss of $80,000 in X2 with respect to its foreign currency transactions. The difference of $24,000 represents the cost of the option. For income tax purposes, BC recognizes the entire option cost of $24,000 as a deduction in X2. The balance in the asset and liability accounts is now zero, and, assuming no further hedging transactions at 12-31-X2, BC reverses the 12-31-X1 deferred tax adjustment.

Put option—cash flow hedge. BC Corp. prepares the same journal entries for the sale and option purchase as those for the fair value hedge. Since BC has an exposed asset position that will lead to a future cash flow, BC may account for the transaction either as a fair value or cash flow hedge.

If BC accounts for the transaction as a cash flow hedge, the company reports fair value adjustments in other comprehensive income, not in the income statement. The balance of the accounting is similar to that accorded the fair value hedge. BC would adjust the receivable and option to fair value at balance sheet dates. As with the fair value hedge, a temporary difference between accounting and income taxation occurs, having deferred tax consequences, at an assumed tax rate of 35%.

The net effect of the above entries is to recognize $4,000 of option expense, which represents the decline in value of the option caused by the passage of time, starting at 12-31-X1, when the option has no intrinsic value. BC does not recognize a deduction for tax purposes, and hence the net temporary difference is $4,000.

At 2-01-X2, BC adjusts the receivable and option to their current values, adjusts accumulated other comprehensive income (AOCI) to reflect the decline in time value of the options, collects the receivable, and exercises the option. By 2-01-X2, the balance in AOCI is zero. BC recognized a $4,000 expense in X1 and a $20,000 expense in X2. The fair value option previously produced far more variable results—$56,000 of income in X1 and $80,000 of loss in X2. Assuming no further hedging activities at the end of X2, BC reverses the 12-31-X1 deferred tax accrual.

Forward contract—fair value hedge. Unlike the purchase of a put option, there is no value recorded for a forward contract at the time of execution since this is a fully executory contract, involving no exchange of assets or other action between the parties. Accordingly, no asset is recorded at that time. BC records the sale at the current spot rate.

BC Corp. knows the cost of extending credit to Dugas at the outset. This cost or discount equals the difference between the spot rate of $1.32 and the forward rate of $1.30 times €2 million [(1.32 − 1.30) × €2 million = $40,000]. The change in the forward rate from the time of the contract is entered until the balance sheet date is a reflection of the value or liability associated with the contract. The value is discounted or given a present value and recorded on the balance sheet along with the adjustment to the fair value of the asset. In this case, since the forward rate has increased to an amount above the forward rate at the time the contract was entered, the contract represents a liability to BC. With fair value hedges, the fair value adjustments appear in income rather than other comprehensive income. As was true with options, a temporary difference between accounting and income taxation occurs, with deferred tax consequences, at an assumed tax rate of 35%.

In X2, the accounts receivable and the forward contract are adjusted to fair value, the euros are received and delivered to the purchaser and, at year-end, the above deferred tax entry is reversed.

Forward contract—cash flow hedge. In X1, BC records the sale, but again makes no entry for the fully executory, forward currency exchange contract, involving no exchange of cash, and having a value of zero. At 12-31-X1, BC adjusts the value of the receivable using the new spot rate and offsets the resulting gain with an adjustment to AOCI. The forward contract is recorded, BC amortizes the cost of the forward contract, and recognizes deferred taxes on the difference between the accounting and taxable base in the balance sheet accounts. While the effective interest method is preferred for purposes of amortizing the discount, FASB's Derivatives Implementation Group permits straight-line amortization of premiums and discounts.

At 2-01-X2, BC again adjusts the receivable and forward contracts to fair value, offsetting gains and losses against AOCI. The foreign currency received is exchanged for cash at the initial contracted forward rate. During X2, BC recognizes the $40,000 cost of the contract for tax purposes and, assuming no further hedging transactions, reverses the 12-31-X1 deferred tax accrual.

Again notice the appeal of cash flow hedge accounting versus fair value hedge accounting. Fair value accounting reported a $299 gain in X1 and a $40,299 loss in X2. Cash flow hedge accounting recognized $26,667 (two months amortization) in X1 and $13,333 in X2. Income effects, especially for hedges involving forward contracts, are determinable at the outset. ❖

> In taxation, an entity must clearly identify the hedging transaction as such on the day entered, and the item hedged must be similarly incurred.

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- *Internal Control Issues in Derivatives Usage and Internal Control–Integrated Framework* (#990011)
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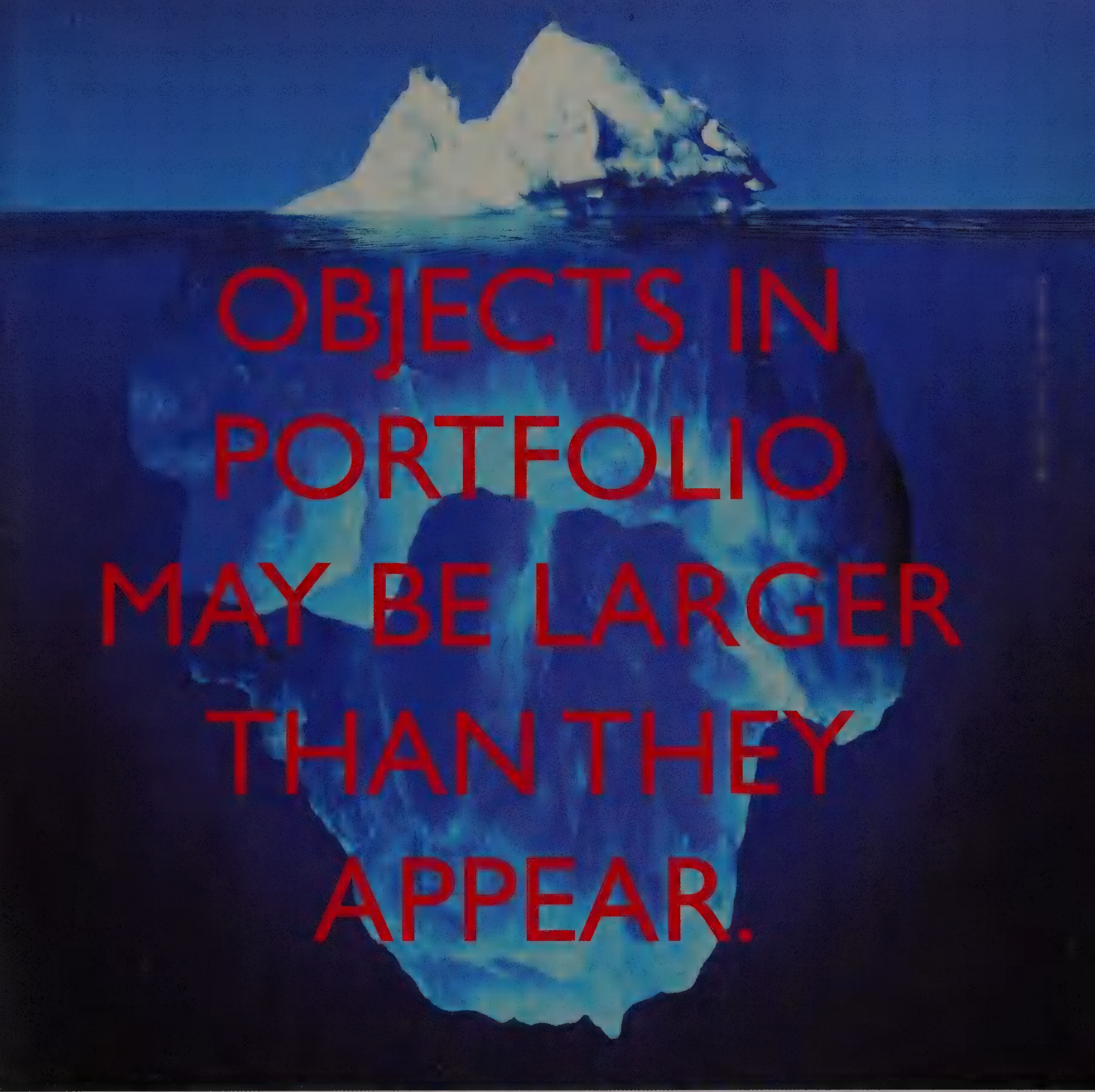
Accounting standards

- FASB Statement no. 52, *Foreign Currency Translation*
- FASB Statement no. 133, *Accounting for Derivative Instruments and Hedging Activities*
- FASB Statement no. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities–an amendment of FASB Statement No. 133*, **www.fasb.org**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XBRL Around the World

A look beyond U.S. shores to put the SEC's interactive data initiative in a global context

by Karen Kernan

XBRL is evolving everywhere, but unevenly, driven by various stakeholders such as governments, stock exchanges, banks and other industry sectors. While the SEC has been finalizing its proposed rule requiring public companies and mutual funds to file their financial reports in interactive data, this article looks beyond U.S. shores to put the United States' progress in a global context.

XBRL, or "interactive data" as the SEC often refers to it, is an open information format standard that enables automated, global sharing of business information as contained in company ledgers, income statements, cash flow, balance sheets, mutual fund risk and returns, as well as textual information included within footnotes and other requirements of business reporting.

XBRL doesn't change the accounting standards or methods used for financial and business reporting, but it puts reported information into an instantly reusable computer-readable format. Computer applications will automatically find comprehensive, granular data the instant it is posted online and flow it into analytical models for deep, automated analysis. XBRL is predicted to have a profound impact on any person or organization that creates or uses business information.

Seeking proof that this evolving language for financial and business information can deliver on its promises of superior data and vastly improved communication, the author interviewed key stakeholders around the world to see who the early adopters are and explore the many ways XBRL is already in use.

XBRL IN EUROPE

While the U.S. and Asia focus on XBRL for use in capital markets, Europe has developed an eye-opening array of governmentwide and cross-border applications that can share consistently structured XBRL data. The first wave of adoption in Europe started about five years ago, with stakeholders in the private and public sectors working together to develop XBRL taxonomies.

(Taxonomies are similar to dictionaries; they are long lists of agreed-upon definitions for all the terms used in specific types of business reports. Each definition has a "tag" that can be read and used by computers.)

Various groups were interested in XBRL's early promise of efficient data gathering and automated analysis, but for different reasons. For example, tax regulators drove development in Ireland, municipalities in Germany, the banking sector in Spain, the Water Board in the Netherlands, and the Companies House in Denmark.

The second wave came as XBRL International's specification was released for commercial use in 2004. Based on work done by the Spanish central bank, the Committee of European Bank Supervisors started using XBRL for Basel II reporting across all 27 member states, though usage was mandatory or optional based on local country regulations.

> XBRL is predicted to have a profound impact on any person or organization that creates or uses business information.

The third wave of XBRL development was inspired by the European Commission. Concerned with the disparity of projects, taxonomies being developed, and various standards being used by its 27 member states, the Commission in 2004 formally urged its member states to register their taxonomies with XBRL International (**www.xbrl.org**) and to work together on a truly open standard.

Just this year, XBRL Europe (**www.xbrl.org/eu**) was formed to generate better consistency, knowledge sharing, and cross-border interoperability of XBRL implementations. The new organization will present a unified voice before the European Parliament and the European Commission as they review XBRL projects. "The big challenge is not to have 27 flavors of XBRL that can't be aggregated across a very diverse region," says Conor O'Kelly, who chairs XBRL Europe's executive committee.

XBRL IN ASIA

In Asia, XBRL is being used by the capital markets. Stock exchanges in China, Japan, Singapore and South Korea all mandate XBRL data. Japan's Financial Services Agency required all public companies to submit financial statements in XBRL format beginning this year. Japanese companies such as Wacoal and Fujitsu have begun to benefit from the use of XBRL for internal applications. In 2004, China became the first country to formally adopt XBRL reporting for its equity markets. Chinese innovation continues to lead XBRL into new areas such as risk profiling, data mining and communicating text information along with financial data.

XBRL is "extensible," meaning local users can extend XBRL taxonomies to satisfy their own needs, but can also extend themselves into isolation. Asian XBRL taxonomy developers often express the need for broader oversight, but unlike the EU, Asia doesn't have a central authority that can mandate cross-border interoperability.

The role of the XBRL International consortium is to recognize the developing XBRL taxonomies of national and regional jurisdictions, and to encourage the creation of quality standards in taxonomy development. But XBRL neither mandates nor enforces local XBRL taxonomies. Many Asian developers expect the recently completed U.S. XBRL taxonomy to have a positive influence in advancing and harmonizing taxonomy development worldwide.

SPEED AND INNOVATION IN CHINA

For a more complete view of current and future implementations of XBRL in China, the author spoke with two active leaders in the XBRL China organization. Bai Shuo is the assistant general manager and CTO of the Shanghai Stock Exchange and a critical influence in the adoption of XBRL for public company reporting. (Shuo's comments represent the viewpoint of the XBRL organization, not the Shanghai Stock Exchange.) We also spoke with Shiping Liu, founder and CEO of Global

Business Intelligence Consulting Co., China's leader in data warehousing and data mining technology.

Both men reflected the enthusiasm that seems to infect the entire XBRL community. "Absolutely!" says Shuo. "The whole country was very excited by this new technology, especially people at the Chinese Securities Regulatory Commission and the Ministry of Finance." They began to seriously study its use in 2003. "We wanted to communicate with people from other parts," he said. They attended international meetings and invited experts from all over the world, including Charles Hoffman, the U.S. CPA credited as the inventor of XBRL, and Liv Watson, another pioneer, who was then vice president of Global Strategy at EDGAR Online Inc. Watson now chairs XBRL International's Development Committee. "We saw so much devotion and energy, and that influenced a lot of people in China," said Shuo.

Early Mandates, No-Cost Compliance

A year later, in 2004, China was the first capital market to adopt XBRL. "The stock exchanges were interested in XBRL for better regulatory reporting," said Shuo. "But the dramatic change in the quality, granularity, and timeliness of the data has had the effect of changing the Western world's view of the Chinese market."

Along with public company reporting, the Shanghai and Shenzhen stock exchanges have begun using XBRL for mutual funds' information releases and expect to use it soon for IPOs as well.

Future Developments: Mining Data and Communicating Text

In the near future, China XBRL expects to see extended use of XBRL for:

- Mutual fund reporting
- IPO approvals
- Non-official, internal financial reporting for smaller companies

Two areas of innovation for future Chinese XBRL applications include:

- Data mining applications for detecting financial fraud. Global Business Intelligence Consulting Co. is developing software to automatically mine the accumulated XBRL database to look for irregular behaviors.
- XBRL for communicating text. Expanded capability for XBRL to communicate additional textual information will allow companies to communicate more fully about their operations and plans, and to directly address an international audience.

How China Moved so Quickly

In part, China was able to move so quickly because companies didn't actually switch to XBRL reporting. They continued to fill out the same forms they always used, while behind-the-scenes software translated line items into XBRL data. This method of implementing XBRL allowed China's capital market to quickly adapt to the new information standard—with no cost of compliance for reporting companies.

The template-based report forms require less financial detail than, for example, the U.S. SEC's proposed rules. This made XBRL translation of Chinese reports relatively easy. Chinese data, XBRL or not, is a more generic, standardized dataset.

A downside of the "hidden" XBRL data generation is that Chinese companies are not going through the learning process U.S. companies now face to comply with the SEC's expected reporting rule. This knowledge is very important, says Shuo, in enabling or inspiring corporate financial professionals to extend what is a superior technology into their internal reporting processes, where they have the potential to realize greater benefits.

While China was the first to mandate XBRL for its equity markets, the sophistication of the XBRL rules and taxonomy have been developed in the West, particularly by the U.S., says Shuo.

The common language for financial and business reporting has already facilitated knowledge sharing and inspired change: The Chinese taxonomy and data collection is expanding, in part, based on what China's financial professionals are

EXECUTIVE SUMMARY

- **While the United States and Asia focus on XBRL for use in capital markets,** Europe has developed an eye-opening array of governmentwide and cross-border applications that can share consistently structured XBRL data for both public and private companies.
- **In Asia, as in the U.S., XBRL is being used by the capital market.** Stock exchanges in Japan and South Korea mandate XBRL data. In 2004, China became the first country to formally adopt XBRL for financial reporting.
- **In the near future, China XBRL expects to see** extended use of XBRL for mutual funds reporting, IPO approvals, and non-official and internal financial reporting for smaller companies.
- **The U.S. is taking a progressive and carefully documented approach to implementing XBRL.** From a capital market perspective, the U.S. had far more technical, legal and infrastructure issues to overcome than smaller countries. However, the SEC's proposed rule for U.S. equity markets will result in the world's most extensive implementation of XBRL.

***Karen Kernan** is an author and communications consultant. Her e-mail address is karen@karenkernan.com.*

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learning from the various taxonomies and underlying accounting standards of other countries. China, in turn, is adding to the international dialogue in other ways, such as its efforts to incorporate key information that is not captured in U.S. GAAP or IFRS, for example, key performance indicators and sustainability reporting.

Investor Use of Chinese Data

"XBRL will become more influential as the entire supply chain matures in its ability to use it," Shuo says. Chinese investors, even institutional investors, are not yet experienced with open financial markets and how best to use public company information. The availability of fast, accurate XBRL data is important, says Shuo, "But so is the understanding of data-based analysis and software tools to support it." XBRL data accumulating for the Chinese market cannot be fully leveraged by the Chinese financial markets without improved software applications for regulators, investors, accounting agencies, statisticians, governmental agencies and the reporting companies.

Ironically, analysts outside the mainland using English-based applications are already leveraging China's XBRL market data. The data is available from the Chinese stock exchange Web sites, directly from reporting companies, or via a direct market data feed. For instance, Credit Suisse HOLT has used XBRL to expand its coverage of the Chinese A-share market from 300 firms, which it previously tracked manually with a lot of cutting and pasting into spreadsheets, to well over 1,000, which it now tracks automatically.

XBRL in the United States

Given the eye-opening progress of XBRL in the capital markets of Asia and Europe, does the coming U.S. mandate for public companies to report in XBRL format simply put the U.S. in a catch-up position?

Not so, says Campbell Pryde, chief standards officer for XBRL US, who is responsible for managing the development of U.S. taxonomies. "The U.S. is the largest, most-developed capital market in the world, and no country has implemented XBRL to the extent that the SEC has proposed for U.S. equity markets."

The U.S., he says, is taking a very progressive and carefully documented approach, and if it has taken this long to "go live," it's because of the enormity of the task. From a capital market perspective, the U.S. has far more technical, legal and infrastructure issues to overcome than smaller countries:

- There are a huge number of stakeholders in the financial supply chain.
- U.S. accounting standards are highly developed.
- Corporate reporting requirements are complex and industry-specific and carry risk for errors (IFRS is more policy-based than industry-specific).
- U.S. companies disclose far more granular and also more contextual information than what is collected in countries that use more generic, template-based report forms, such as those used in China and Japan, and for private companies in Europe.
- The burden of compliance had to be low before the SEC could require the approximately 17,000 public companies and 8,000 mutual funds to start filing XBRL data.

The U.S. Taxonomy

Few outside the XBRL developer community understood the enormity of the accomplishment when the U.S. XBRL organization last May presented the SEC with the complete taxonomy for U.S. GAAP—a last remaining obstacle to going live. Broken out by industry sectors, the U.S. taxonomies currently include more than 12,400 XBRL tags and definitions for the standard accounting terms used in U.S. GAAP. This is nearly double the size of any other national taxonomy.

Even for those not involved in creating XBRL data, or who do not yet use XBRL-enabled financial software, it is worth taking a look at the U.S. XBRL taxonomy, available online (**http://xbrl.us/pages/us-gaap.aspx**). Viewers can quickly see how XBRL data is structured and extended. Each data point can be searched and used in automated analysis. Additionally, the US GAAP Taxonomies reference many of the related FASB standards and SEC Regulation SX sections, which not only enhance the transparency of reported information, but also transform how professionals use these resources relevant to company disclosures.

> From a capital market perspective, the U.S. has far more technical, legal and infrastructure issues to overcome than smaller countries.

The Unlimited Future in the World of Interactive Data

What happens as the world's financial supply chain begins to share a single language for interactive financial and business information? Investors will be able to find numbers they can understand on hundreds of companies around the world. They will be able to find comparable data automatically, at low or no cost, on a variety of Web sites.

Conor O'Kelly, who is also vice chairman of XBRL International, expects the next global wave of XBRL development to be in standard business reporting projects, looking at how government agencies can unify and simplify data collection. The Netherlands is leading this wave, with Australia and New Zealand close behind. There's no technical reason there should not be one central repository for all government data collection and

Europe's XBRL Leader

Since the Spanish central bank knew it could not compete as Europe's largest player, it was determined to become Europe's most efficient.

When the European Commission (EC) announced its new XBRL reporting initiative, the bank shifted its focus to the larger issue of a standard communication platform for efficient cross-border communications and presented a surprised EC with a list of the business requirements it had already defined, that could serve the European Union's larger XBRL project.

The central bank was not alone in Spain's close-knit community of financial professionals who had been studying XBRL. Members of the newly formed XBRL Spain organization included market regulators, representatives of government agencies, public and private businesses, and more.

Under the central bank's leadership, XBRL Spain consolidated various XBRL initiatives and began in earnest to develop national taxonomies for financial reporting and for data exchange between financial institutions, including COREP, the common reporting framework for credit institutions and investment firms in the European Union; FINREP, the financial reporting for credit institutions that use IAS/IFRS for their published financial statements and periodic reports required by supervisory authorities; and SEPLAC, a system for the prevention of money laundering and other illegal monetary transactions.

XBRL was adopted for the entire banking industry in Spain, soon followed by the capital markets. Now the focus is on Spain's governmentwide approach, including XBRL reporting by municipalities and private companies. XBRL Spain is working with software vendors to XBRL-enable standard accounting applications so they can automatically generate XBRL data associated with reports.

dissemination to the public.

The SEC has created an Interactive Disclosure office, which is expected to look beyond quarterly and annual reporting, to study the general issue of data collection and the creation of central repositories. Large data repositories could be used for all types of information collected from the marketplace, such as a central repository for mutual funds, which are now reported separately.

XBRL is simply structured data. Such a language does not have to be confined to IFRS or U.S. GAAP, or to any national language, as nicely demonstrated by the Israeli "Manga" system that lets users simply toggle to see information in English. Today, XBRL taxonomies accommodate more than 30 regional languages. As SEC Chairman Christopher Cox remarked, "This is so obviously what computers were made for, it's hard to believe investors could never do this before."

There are huge opportunities for gathering statistical data, or information in the health industry or for environmental pollution control compliance, resource management, oil and gas reserves, and more. Already, the Global Reporting Initiative (**www.globalreporting.org**), a group committed to sustainability, has developed an XBRL taxonomy for the many indicators itemized in its sustainability framework, to automate and support more sustainability reporting.

"It's going to be interesting to see how XBRL in the United States seeps down from regulatory filings and works its way into the general market," says Liv Watson. "XBRL will gain its foothold in regulatory filings, but as the market finds its comfort zone, it will quickly see XBRL's potential for broader financial reporting, internal reporting, scorecarding and general knowledge management."

XBRL is even being used in the poorest emerging countries. The Microfinance Information Exchange Inc. (MIX), which acts as a clearinghouse, tracks the performance of nearly 1,000 microfinance institutions and has adopted XBRL as the core technology. The goal of improved information exchange and reporting is to encourage investment and success for microfinance projects worldwide.

"We are creating market enablement—we are creating a standard that will allow the market to exchange information more efficiently, with greater transparency and interoperability, with more efficient flow of capital," says XBRL Europe's O'Kelly. "But we can't predict what the market will do with these capabilities. It's like creating the MP3 format: the developers knew it worked to play music files, but they couldn't have envisioned Napster or iTunes. The role of international developers is just to make sure there is a robust, scalable, interoperable open standard for the market to use in whatever ways it will find." ❖

AICPA RESOURCES

JofA articles

- "Six Steps to XBRL," Feb. 08, page 34
- "ROI on XBRL," June 07, page 32

Web site

Information Technology Center, **http://infotech.aicpa.org/Resources/XBRL**

OTHER RESOURCES

- XBRL US, **http://xbrl.us**
- XBRL International, **www.xbrl.org**

EUROPE

BELGIUM

- Since January 2008, XBRL has been mandatory for all filings of annual accounts to the National Bank of Belgium.
- The Directorate-general Statistics and Economic Information is studying how companies could save time completing survey reports about their structure, using data already submitted in their annual accounts.

FRANCE

- The Bank of France has already adopted XBRL for regulating the banking sector.
- The French GAAP taxonomy is currently under construction, and the decision by the AMF (the securities regulatory body) on the use of XBRL for the reporting of public companies is expected by year-end.

GERMANY

- German small- and mid-cap companies already report in XBRL though many filers are not aware of this fact, since they continue to use the same online forms. DATEV, the officially sanctioned clearinghouse, generates the XBRL data from filed reports.
- Private companies are also required to report. The German Public Register Authority (Bundesanzeiger) enabled XBRL filing last year and has received XBRL data from approximately 1 million entities.

ITALY

- Still in pilot project stages, Italy is moving rapidly with legislative support.
- About 900 annual and consolidated accounts began filing last year with chambers of commerce in Italy.

NETHERLANDS

- The Dutch government is using XBRL as one aspect of an ambitious program to reduce by 25% the cost of financial, tax, statutory and statistical reporting compliance.

SPAIN

- The Spanish banking industry adopted XBRL for various reporting requirements, followed by the capital markets.
- Now the focus is governmentwide, including XBRL reporting by municipalities and private companies (see "Europe's XBRL Leader," p. 66).

UNITED KINGDOM

- Thousands of companies already report in XBRL, which will be mandatory in 2011.
- The tax authority (HMRC) has a voluntary XBRL filing service, which also will be mandatory in 2011.

ASIA

CHINA

- In 2004, China became the first country in the world to formally adopt XBRL reporting for its equity markets.
- In the near future, China XBRL expects to see extended use of XBRL for mutual fund reporting, IPO approvals and non-official, internal financial reporting for smaller companies.

JAPAN

- Recently mandated XBRL format reporting for approximately 5,000 public companies and 3,000 investment funds. XBRL, which addresses language barriers, is expected to help attract foreign investors.
- Since 2006, the Bank of Japan has used a voluntary XBRL reporting program for financial service institutions, gradually expanding the range of reports, and implementing the latest technology such as Formula link and Dimensions.

SOUTH KOREA

- As of 2007, all publicly held companies file financial statements using XBRL on the electronic filing system of the Korea Financial Supervisory Commission. The system allows viewers to see and analyze a company's financial statements in English.

INDIA

- Both the Bombay Stock Exchange and the National Stock Exchange currently accept voluntary XBRL documents and are moving toward mandates with the support of the Securities and Exchange Board of India.
- The Reserve Bank of India has included XBRL in its strategy plan for 2010 and in May 2008 it awarded a contract to a local vendor to start its implementation of a full-fledged XBRL filing solution.

SINGAPORE

- The Accounting & Corporate Regulatory Authority of Singapore requires some 60,000 companies to file their financial statements in XBRL, though companies such as banks, and insurance and finance companies regulated by the Monetary Authority of Singapore are presently exempted from this requirement.

THE AMERICAS

CANADA

- A voluntary XBRL filing program is now in effect, but most companies are waiting for IFRS to take effect before switching to XBRL as the reporting language for communicating the financial and business information.
- XBRL Canada is working on a taxonomy that conforms to IFRS.

CAYMAN ISLANDS

- In June 2008, the Cayman Islands Monetary Authority (CIMA) released the first comprehensive assessment of the offshore hedge funds industry available—made possible by a new XBRL-based electronic reporting platform—that gives CIMA the ability to aggregate and report in-depth statistics on 5,052 Cayman Islands-regulated funds representing a net asset value of $1.387 trillion.

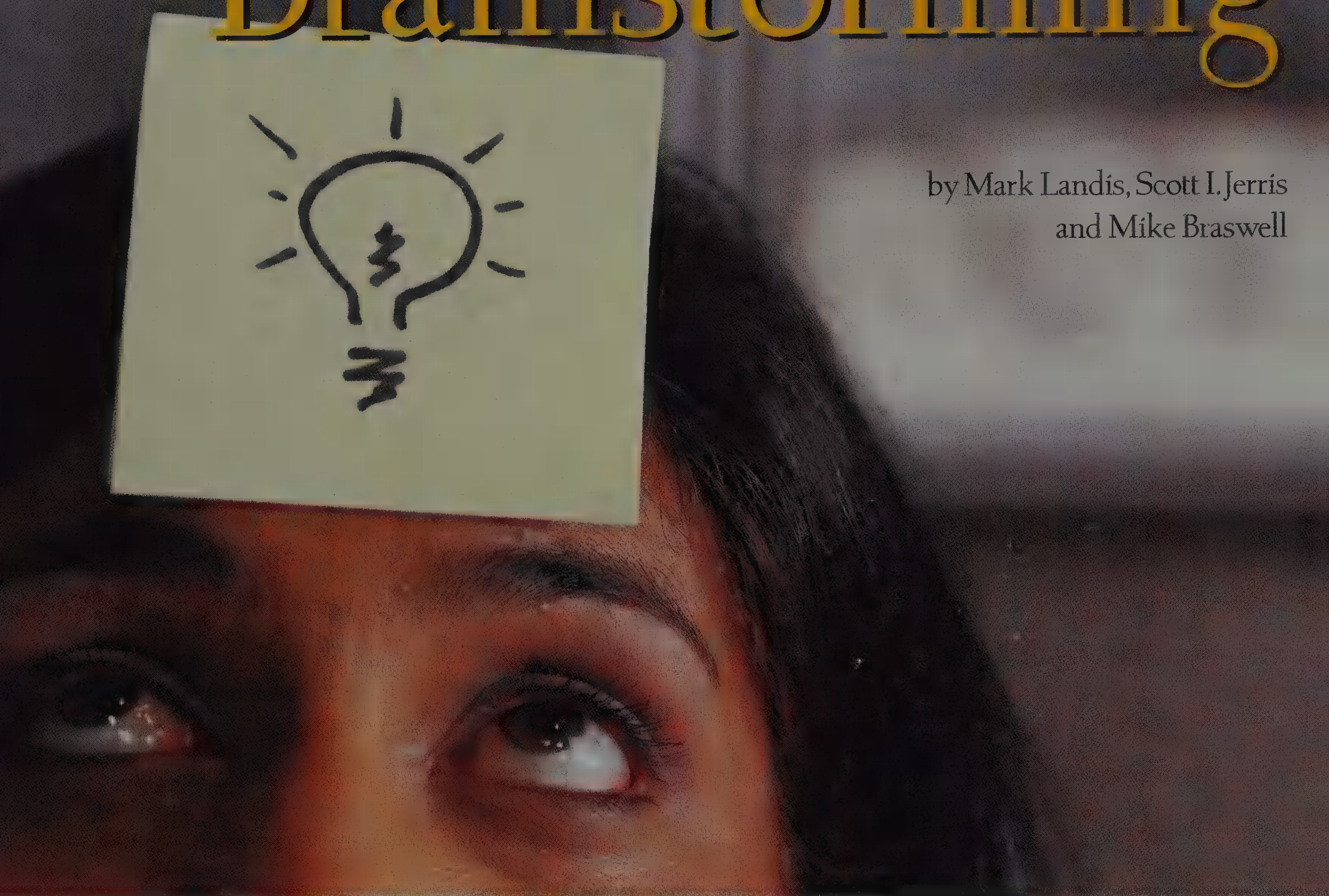
SOUTH AMERICA

- The central banks are the main drivers of XBRL development throughout Latin America.
- Bolivia is taking a governmentwide approach.
- Chile's capital markets are actively exploring XBRL.

UNITED STATES

- The FDIC currently collects bank financial statements (call reports) in XBRL format from more than 8,300 U.S. banks on a quarterly basis.
- The SEC's Voluntary Filing Program established in 2005 allows public companies to voluntarily submit XBRL documents as exhibits to periodic reports and investment company act filings. Approximately 80 companies have participated in the program. In May of this year, the SEC proposed a rule to mandate the use of XBRL for companies' financial statements. More than 80 comment letters were submitted to the SEC, and a final ruling is expected by the end of the year.

Better Brainstorming



by Mark Landis, Scott I. Jerris and Mike Braswell

In a report issued in January 2007, the PCAOB raised concerns about accounting firms falling short of brainstorming requirements in auditing standards. It cited three issues: brainstorming sessions sometimes occurred after the planning phases of the audits; some audits did not include a brainstorming session; and key members of the audit team did not always attend the brainstorming sessions.

Two auditing standards, SAS no. 99, *Consideration of Fraud in a Financial Statement Audit*, and SAS no. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, mandate brainstorming sessions. SAS no. 99 requires that auditors brainstorm to determine possible fraud risks, while SAS no. 109 requires that auditors brainstorm to identify additional causes of potential material misstatements in the financial statements.

Now that several years have passed since the first SAS no. 99 brainstorming sessions were implemented in 2002, the profession has had an opportunity to study which aspects of these sessions are most effective. The recommendations in this article are based primarily on the findings of academics and regulators, with some observations from a partner at an international firm. The suggestions are designed to improve the productivity of brainstorming sessions.

Generating Ideas

One surprising finding (not specific to the auditing profession) consistently documented by psychologists is that people participating in brainstorming sessions tend to

produce *fewer* unique ideas than when those people act alone. In a study conducted by Tina Carpenter at the University of Georgia, this phenomenon was observed in auditors when brainstorming teams and individual auditors were asked to identify fraud risks for the same company. Brainstorming sessions, on average, generated fewer unique ideas than auditors acting individually.

However, these findings do not mean auditors are better off scrapping the brainstorming sessions. In fact, brainstorming sessions are quite useful. While groups may not be able to generate as *many* ideas as individuals, brainstorming teams tend to generate a greater number of *better* ideas than individuals.

Given the dynamics of teams, one effective tool for boosting the number of ideas is to use computer-mediated communication. This can be as simple as a conference call or instant messaging software, or may be more complex software packages called group decision support systems. These software packages offer voting tools, electronic bulletin boards and preprogrammed agendas to facilitate group discussions.

One purpose of group decision support systems is to reduce inefficiencies that occur in face-to-face meetings. In conference calls, people can jot down notes for later without appearing disinterested in the conversation. In instant messaging, participants can relay a message at any time without interrupting anyone else. Additionally, the physical distance between members can make people feel less inhibited and can reduce the social anxieties of participating in discussions. One additional benefit of computer-mediated communication systems is the reduction in travel expenses that results when auditors don't need to be physically in the same place to conduct the brainstorming sessions.

A second recommendation is to briefly discuss past cases of fraud or sources of misstatements. These discussions may stimulate ideas and lead team members to consider how those past lessons apply to the current engagement.

If checklists are used, teams should fully flesh out an item on the checklist—for example, fully explore a potential high-risk area—before proceeding to the next item. Psychology research has shown that if brainstorming teams spend adequate time on a given topic, the teams will typically generate as many ideas as individuals brainstorming alone.

We also recommend that the group leader allow the discussion to veer away from the checklist so other areas of potential risk may be explored. A checklist may be an essential guide for discussions, but the discussions should not be limited to risk areas indicated on the checklist.

Ideally, an audit partner should lead the brainstorming session. Studies have shown that average members of brainstorming groups rise to the level of the best members. If there aren't strong members available, they will actually fall to the level of the least engaged members. Therefore, it is crucial to have a highly qualified person leading the session. If an audit partner does not lead the session, someone who is recognized as an expert on the audit should.

While forensic specialists have expertise that may serve as a standard of quality in the brainstorming session, partners are generally perceived as possessing the expertise and organizational status that newer members of the brainstorming team usually aspire to achieve. Thus, partners are ideal brainstorming leaders, and other team members are more likely to try to "rise to the level" of the partner.

EVALUATING IDEAS

Three common trouble spots can arise as auditors evaluate ideas stemming from brainstorming sessions. First, the evaluation—especially critical assessments—may stop the flow of new ideas. Outside of the auditing profession, the first two phases of brainstorming sessions—generating and evaluating ideas—tend to be strictly separated. Some audit brainstorming sessions combine those phases. This can increase the efficiency of the audit by shortening the session and quickly allowing auditors to dismiss inaccurate suggestions from members, but at some risk.

EXECUTIVE SUMMARY

- **The PCAOB in 2007 raised concerns about accounting firms** meeting the brainstorming mandates of SAS no. 99, which requires auditors to brainstorm to determine possible fraud risks, and SAS no. 109, which requires auditors to brainstorm to identify additional causes of potential material misstatements in financial statements.
- **Given the dynamics of teams, one way to increase the number of ideas** generated in a session is to use computer-mediated communication. It can be as simple as a conference call or instant messaging software, or more complex software packages called group decision support systems. These software packages offer voting tools, electronic bulletin boards and preprogrammed agendas to facilitate group discussions.
- **Ideally, an audit partner should lead the brainstorming session.** Checklists, if they are used, should be limited to use by the brainstorming leader as a discussion guide. Without a checklist in front of them, audit team members are more likely to consider the ideas generated in the group discussion as their own ideas rather than considering them to be suggested by the checklist. Thus, team members are less likely to underestimate the importance of those items.
- **A portion of each brainstorming session should** specifically address the ramifications of the session's findings on the audit plan. At one international accounting firm, auditors categorize potential risk areas as having a high, medium or low likelihood of occurring. Team members then develop specific audit procedures to reduce the risks to acceptable levels. Brainstorming sessions are documented in a formal risk assessment memo.

***Mark Landis**, Ph.D., is an assistant professor of accounting, **Scott I. Jerris**, Ph.D., is a professor of accounting, and **Mike Braswell**, Ph.D., is an assistant professor of accounting, all at San Francisco State University. Their e-mail addresses are, respectively, landism@sfsu.edu, sjerris@sfsu.edu and braswell@sfsu.edu.*

To mitigate the pressure on audit team members, audit teams should designate time for the generation of ideas and set aside time to evaluate those ideas. This prevents the "shutting down" of team members because their ideas were criticized during the evaluation stage.

Another potential pitfall is group shift. If a group of like-minded people gets together and discusses a topic, the discussion very often leads group members to intensify their initial beliefs. This is referred to as "group polarization" or "group shift." Audit research has shown that when auditors are discussing client risks in general, they intensify their beliefs regarding the client's risks. The group tends to consider the identified risks more troublesome than if each individual auditor assessed the risks alone.

Group shift can be used to the auditors' advantage. To encourage a conservative group shift, include a partner in the evaluation of ideas. Academic research has shown that when partners, managers and audit associates examine the same potential risk, partners tend to believe the risk is more severe than managers or associates do.

If one team member believes that a potential risk area is more serious than other team members believe, that team member should be given time to make an argument. And the team leader should remind members of the purpose of the brainstorming session, as well as the importance of professional skepticism when evaluating information, at the beginning of the evaluation stage. Such framing has been shown to have profound effects on decisions.

Teams should frame the goal of the brainstorming session as identifying potential areas of risk rather than, for example, using the session as a means to whittle away low-risk areas so the audit team can focus on high-risk areas. This positioning makes the team more likely to induce a conservative group shift, leading to a more thorough assessment of potential risk areas.

Checklists also can change the course of idea evaluation. A study by Stephen K. Asare and Arnold M. Wright published in *Contemporary Accounting Research* in 2004 found that auditors who use checklists tend to believe that a risk factor on that checklist is less serious than auditors who don't use checklists. The phenomenon appears to be rooted in the fact that people are more likely to consider their own ideas more important and relevant to a decision than information suggested by other people, or in this case, a checklist.

While groups may not generate as *many* ideas as individuals, brainstorming teams tend to generate a greater number of *better* ideas.

Checklists, if they are used, should be limited to use by the brainstorming leader as a discussion guide. Without a checklist in front of them, audit team members are more likely to consider the ideas generated in the group discussion as their own ideas rather than considering them to be suggested by the checklist. Thus, team members are less likely to underestimate the importance of those items.

Incorporating Ideas

Once ideas regarding potential risks of fraud and sources of financial misstatements have been generated and evaluated, the audit team must consider what to do with them. A portion of each brainstorming session should specifically address the ramifications of the session's findings on the audit plan. Adjustments to the scope of audit tests, a redeployment of specialists, or increased involvement by higher-ranking members of the audit team in higher-risk areas may be just some of the changes to the initial audit plan.

A substantial amount of accounting and psychology research details how these discussions can affect judgments regarding the materiality or potential severity of identified risk factors. These findings come with a very serious caveat: Research is unclear as to whether auditors are actually modifying the initial audit plan to account for risk factors identified in the brainstorming session.

A study by Jody Bellavory and Karla Johnstone at the University of Wisconsin–Madison found that auditors reported they did in fact modify the audit plan. However, the PCAOB, in its 2007 report, found that auditors were not sufficiently investigating identified fraud risk factors. Preliminary results of some academic work in progress suggest that the audit plan was modified, but only when the brainstorming sessions were of high quality.

At one international accounting firm, once potential risks are identified, auditors categorize them as having a high, medium or low likelihood of occurring. Team members then develop specific audit procedures to reduce the risks to acceptable levels. Brainstorming sessions are documented in a formal risk assessment memo that lists the participants, risks identified, the rationale of the likelihood assessment, and the planned audit procedures. The PCAOB

AICPA RESOURCES

JofA article
"A Primer for Brainstorming Fraud Risks," Dec. 03, page 32

CPE
Detecting Misstatements: Integrating SAS 99 and the Risk Assessment Standards, a CPE self-study course (#733790)

For more information or to place an order, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

OTHER RESOURCES

Articles
- "Audit Team Brainstorming, Fraud Risk Identification, and Fraud Risk Assessment: Implications of SAS 99," *The Accounting Review*, Oct. 2007
- "Descriptive Evidence from Audit Practice on SAS No. 99 Brainstorming Activities," *Current Issues in Auditing*, Sept. 2007

Study
PCAOB study, *Observations on Auditors' Implementation of PCAOB Standards Relating to Auditors' Responsibilities With Respect to Fraud*, **www.pcaobus.org/Inspections/Other/2007/01-22_Release_2007-001.pdf**

examines the risk assessment memo while performing reviews of the audits of public companies and uses the memo as a guide in its inquiry into the procedures employed throughout the audit.

Final Thoughts

The auditing standards place considerable emphasis on the brainstorming sessions. To be most effective, the sessions should occur near the beginning of the audit so the audit plan may be appropriately modified, even though SAS no. 99 calls for continued group discussions throughout the course of the audit to be sure that potential areas of fraud are adequately sought out and identified. Ultimately, the goal of these sessions is to increase the quality of audit services provided to clients, and, if done properly, brainstorming sessions can be a particularly useful tool for the auditor to provide reasonable assurance against material misstatements of financial statements due to fraud or error. ❖

Better Brainstorming Recommendations

Generating Ideas

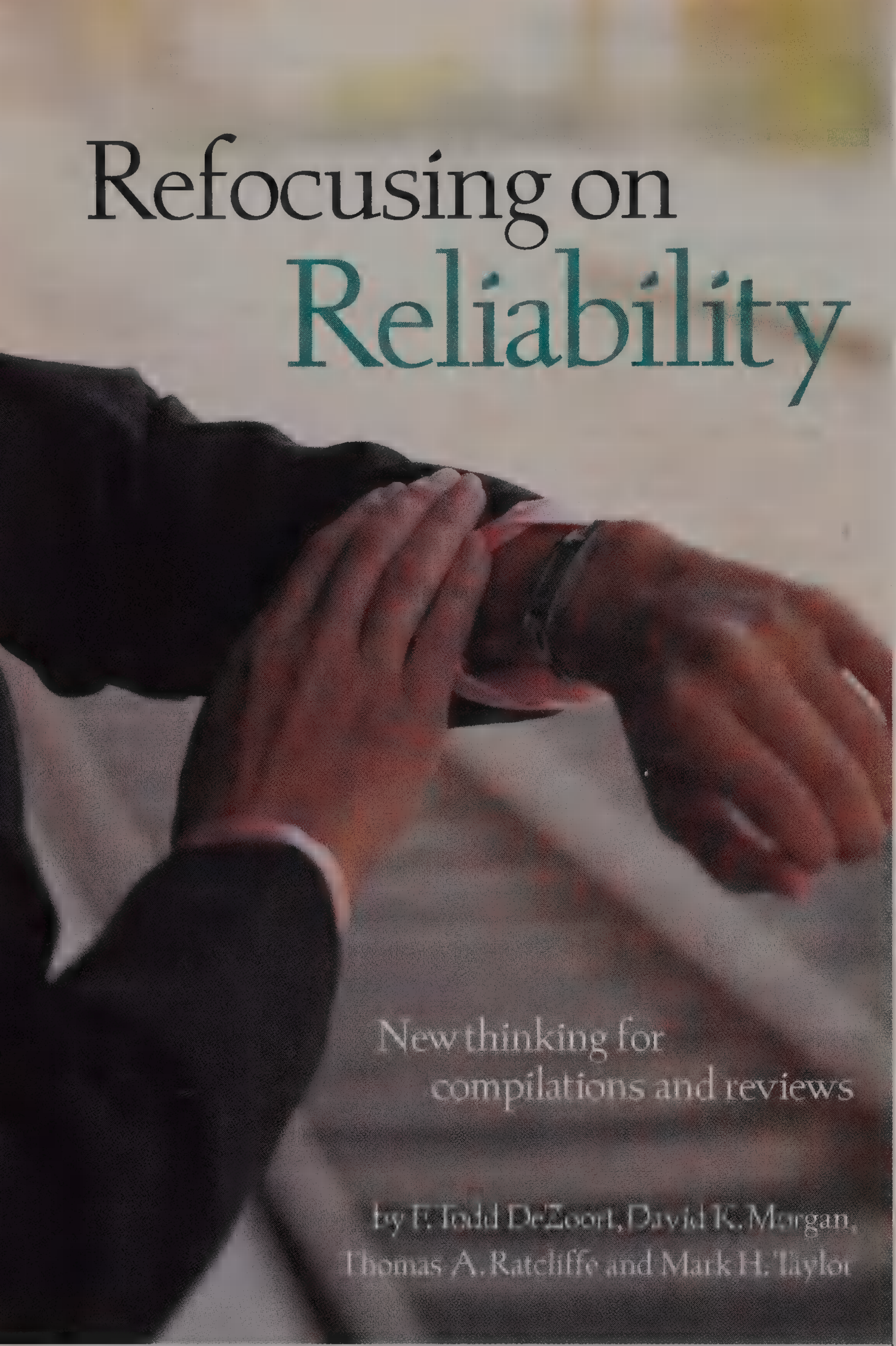
- Use group decision support systems.
- Discuss cases of fraud or sources of material misstatements from prior audits.
- Checklists should only be used by the team leader.
- If checklists are used, fully discuss each item on the list.
- Don't limit discussions to items on the checklist.
- Have the engagement partner or another expert on the audit lead the brainstorming session.

Evaluating Ideas

- Separate the idea generation phase from the idea evaluation phase.
- Include a partner in the evaluation of ideas.
- Encourage members to discuss why they feel an identified risk is important.
- Remind members of the purpose of the brainstorming session and the importance of professional skepticism.

Incorporating Ideas

- Set aside time at the end of the brainstorming session to indicate how the audit plan should be modified as a result of the session.



Refocusing on Reliability

New thinking for compilations and reviews

by F. Todd DeZoort, David K. Morgan, Thomas A. Ratcliffe and Mark H. Taylor

For more than three decades, the AICPA Accounting and Review Services Committee (ARSC) has developed technical guidance for review and compilation engagements with the overarching objectives of serving the public interest and providing practitioners with the guidance needed to perform and report effectively. ARSC has developed the authoritative literature within the Statements on Standards for Accounting and Review Services (SSARS) on a foundation of tenets associated with the need to be independent to perform assurance engagements, such as reviews, along with the need to modify reports in circumstances where independence has been impaired when performing nonassurance engagements, such as compilations.

However, issues that have emerged among financial statement users, preparers, assurers, regulators and other stakeholder groups suggest that client-based independence rules are, in some cases, an obstacle to helping clients provide reliable financial reports. This article, written by members of the AICPA's Reliability Task Force, describes the work of the task force, the evolving refocus on reliability, and prospective changes in compilation and review standards.

The task force has concluded that barring accountants from expressing some level of assurance if they play a role in the client's internal control is impractical for many smaller entities. Some entities cannot prepare reliable financial statements without their CPA playing a role in certain control activities. Therefore, the task force believes that the public interest would be served by allowing CPAs to perform select nonattest services, such as certain internal control activities, while also performing a review of those financial statements.

The Reliability Framework

In 2003, *Accounting Horizons* published a paper titled "A Proposed Framework Emphasizing Auditor Reliability over Auditor Independence," co-authored by Mark H. Taylor, F. Todd DeZoort, Edward Munn and Martha Wetterhall Thomas. The paper provided a framework (see Exhibit 1) emphasizing reliability as the professional "end game" for CPAs providing assurance services. The framework defines CPA reliability as a condition in which stakeholders consistently find the CPA's work credible and dependable, even after acknowledging the engagement's inherent limitations. In this context, a CPA's performance of control-related activities promotes the financial reporting reliability, which is emphasized as a critical qualitative characteristic of financial information.

This framework highlights integrity, independence and expertise as key ethical constructs underlying the pursuit of objectivity, which in turn enables professional reliability. Specifically, the authors suggest

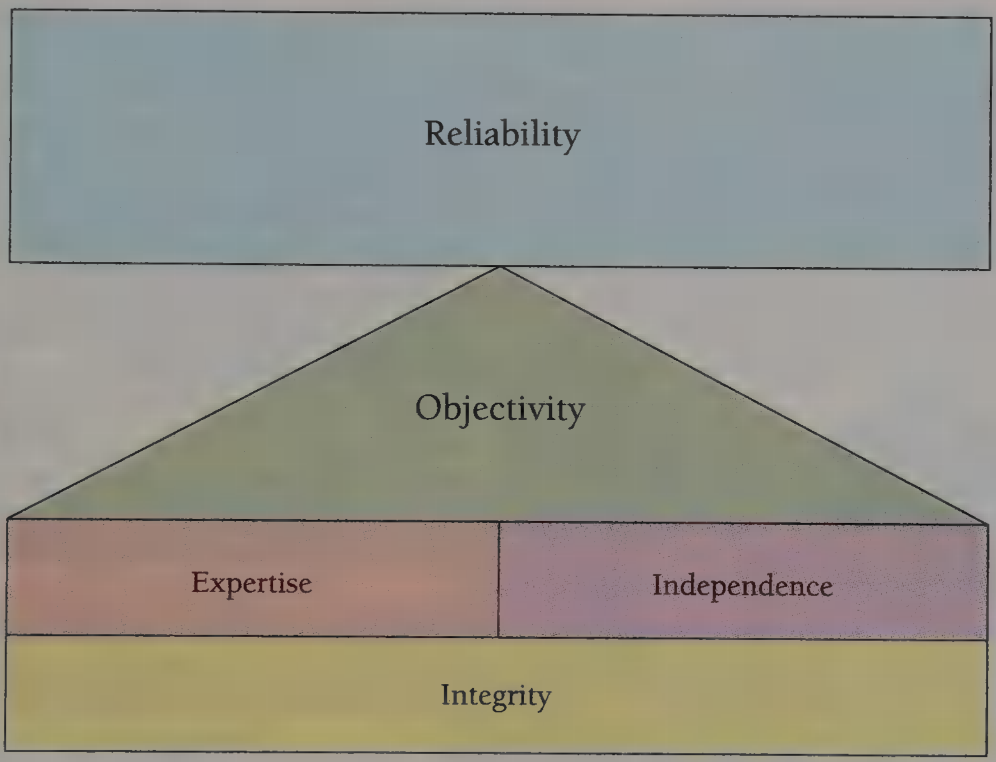
that CPAs cannot be completely independent for a number of reasons, including the fact that the client pays the CPA's engagement fee. Thus, CPAs always face some degree of independence impairment, even if they are not impaired under professional standards.

The framework suggests that the CPA's integrity and competence may be appropriate safeguards that provide for the possibility of CPA and financial reporting reliability in situations where the CPA lacks technical independence under professional standards based on scope of service issues.

The AICPA's Interest in the Reliability Framework

The AICPA's Audit and Attest Standards Team held several meetings to discuss the published framework and its implications for policymaking and practice. Ultimately, the AICPA formed a task force of practitioners, preparers, researchers and third-party users to study the issue and consider making recommendations to ARSC. The Reliability Task Force first considered the assurance continuum in Exhibit 2 to better understand ARSC's responsibilities and scope of authority.

Exhibit 1 Reliability Framework



Current SSARS allow CPAs to perform compilations when independence has been impaired. However, CPAs lacking independence when performing compilations should disclose that lack of independence in their report, although they are precluded from disclosing the reasons independence is impaired. Alternatively, current standards do not allow a review if independence is impaired. Specifically, CPAs cannot provide limited assurance by means of a review when they are not independent with respect to the reporting entity.

Exhibit 3 depicts the current "independence-based" model for the performance of attestation engagements. In this model, the client's financial data are first processed through its internal control over financial reporting (ICFR). The financial data may then be subjected to the CPA's audit, review or compilation procedures. Third parties can then use the resulting report and financial statements in making decisions such as whether to make a loan or extend surety bonding.

However, this model is difficult to achieve in the real world, particularly for smaller clients that need CPAs to do more than simply compile or review their financial statements. To achieve reliable financial reporting, these clients often require their CPAs to perform certain nonattest services related to

EXECUTIVE SUMMARY

- **Current technical literature precludes CPAs** from performing review engagements when independence is impaired and requires modifying reports to disclose lack of independence in compilation engagements.
- **The AICPA Reliability Task Force asserts** that the conceptual foundation regarding the services CPAs provide to clients should be modified to refocus on reliable financial statements as the end game.
- **The task force concluded that CPAs** can maintain their objectivity and provide review services even when performing control-related activities for clients.
- **The task force recommends** that the Accounting and Review Services Committee develop a new reliability framework that would allow review engagements where independence from ICFR services would not be required.

***F. Todd DeZoort**, Ph.D., is professor of accounting and accounting advisory board fellow in the Culverhouse School of Accountancy at The University of Alabama. His e-mail address is tdezoort@cba.ua.edu. **David K. Morgan**, CPA, is the co-managing partner of Lattimore Black Morgan & Cain PC in Nashville, Tenn. His e-mail address is dmorgan@lbmc.com. **Thomas A. Ratcliffe**, CPA, Ph.D., is director of accounting and auditing at Wilson Price in Montgomery, Ala. His e-mail address is tomr@wilsonprice.com. **Mark H. Taylor**, CPA, Ph.D., is professor of accounting and John P. Begley endowed chair in accounting in the College of Business Administration at Creighton University in Omaha, Neb. His e-mail address is mhtaylor@creighton.edu.*

bookkeeping, payroll and accounting controls. Specifically, to help ensure reliable financial reporting, Exhibit 4 depicts a scenario in which CPA services intersect with internal control functions that have been reserved for the client in the traditional model.

However, in many cases, this intersection impairs the CPA's independence under independence standards such that a review engagement cannot be performed, and there would be a need to disclose impaired independence in reports resulting from compilation engagements.

Exhibit 2 Assurance Continuum

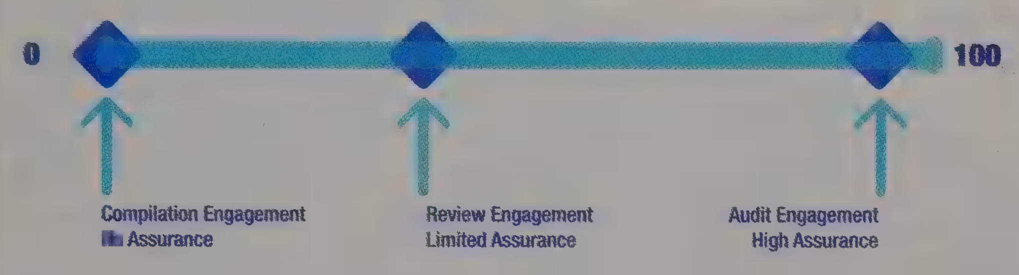


Exhibit 3 Traditional Model for Performance of Financial Reporting Engagements

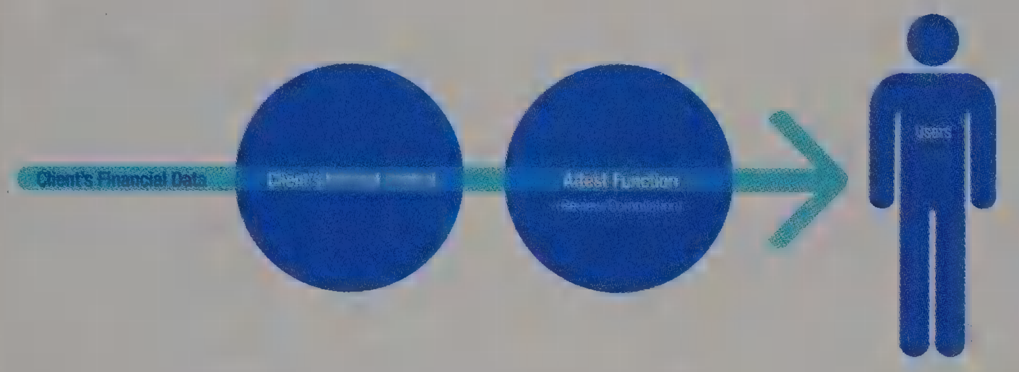
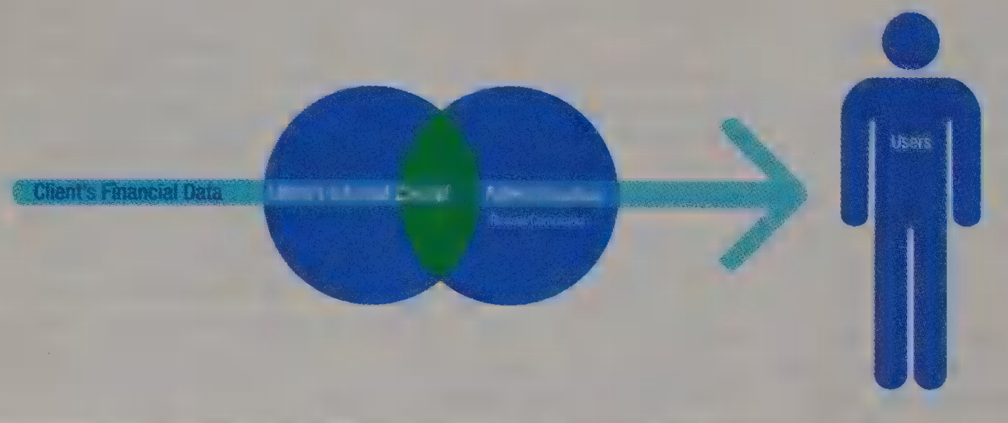


Exhibit 4 Alternative Model for Performance of Financial Reporting Engagements



Consistent with the reliability framework, when considering current independence rules and the goal of reliable financial statements, the task force distinguished independence impairments associated with two areas—financial or relationship interests and performance of certain nonattest services.

CPAs in small and medium firms often perform certain ICFR activities for their clients to improve the reliability of financial reporting. Many users believe that these types of services are extremely valuable in enhancing financial statement reliability for businesses that otherwise would be unable to prepare accurate accounting records and financial statements, and that such services do not impair the CPA's objectivity. However, while these services have the potential to improve the reliability of financial reporting, they technically impair independence and disqualify the CPA from issuing a review report under current standards.

For example, a CPA who performs bookkeeping for a client—assigning general ledger codes to receipts and disbursements and posting them to the general ledger because the client lacks relevant competence—increases the likelihood that receipts and disbursements will be accurately accounted for. These services, in turn, increase the likelihood that the client's subsequent financial statements will be reliable. However, this activity would likely violate current independence standards because the decision on coding and posting would most likely be considered a management decision.

The task force believes that maintaining a stance that accountants cannot express some level of assurance if they do not comply with the existing independence model, where they can play no role in the client's internal control, is not practicable for many smaller entities and not in the public interest. Although the task force reaffirmed the importance of "financial-interest" independence (for example, no direct investments in the

AICPA RESOURCES

JofA article

"Navigating the Crossroads of Control and Independence," Dec. 07, page 42

Publications

- The March 2008 report *Recommendations of the Reliability Task Force: Consideration of an Alternative Framework for Compilation and Review Engagements* is available at **www.aicpa.org/download/auditstd/Recommendations_of_the_Reliability_Task_Force_-_FINAL.doc.**
- *Compilation and Review 2007/08—Risk Alert* (#022308)

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client) and "relationship-based" independence (for example, ensuring that an immediate family member of the CPA is not in a key management position at the client), it emphasized the importance of flexibility and latitude when considering independence requirements for compilation and review engagements as those requirements relate to nonattest services performed.

For example, if independence is impaired because CPAs perform certain nonattest services to improve the reliability of client financial reporting, the task force believes CPAs should be permitted to express limited assurance on the client's financial statements provided they maintain their financial-interest and relationship-based independence, integrity and expertise needed to pursue objectivity. The end result should be more reliable financial reporting.

The task force recommended that ARSC proceed with developing a standard that would allow review engagements in cases where the CPA performed client ICFR services (see Exhibit 5). ARSC has begun deliberating over whether to incorporate the reliability framework into the SSARS literature.

Given the relatively high level of assurance provided by audits, the task force concluded that it would not be appropriate to make a similar recommendation to the Auditing Standards Board. However, task force members recognize that the importance of the reliability framework's tenets suggests the need for future consideration by the AICPA's Professional Ethics Executive Committee of the implications.

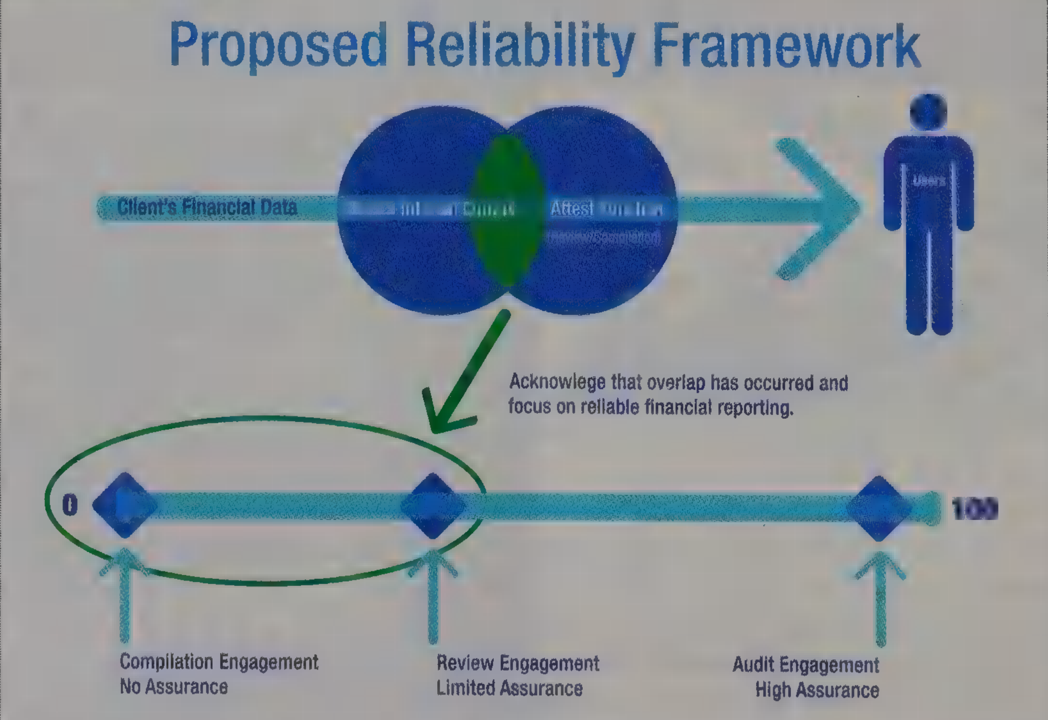
Task force members believe the potential changes to the ARSC foundation are driven by a systematic consideration of market factors. These factors include demand for high-quality services, users who expect CPAs to fulfill needs that currently compromise independence rules, and thought literature that suggests equal emphasis on independence, competence and integrity, paving the way to pursue CPA objectivity that yields reliable financial information. Essentially, the task force concluded that reliability should be the end game.

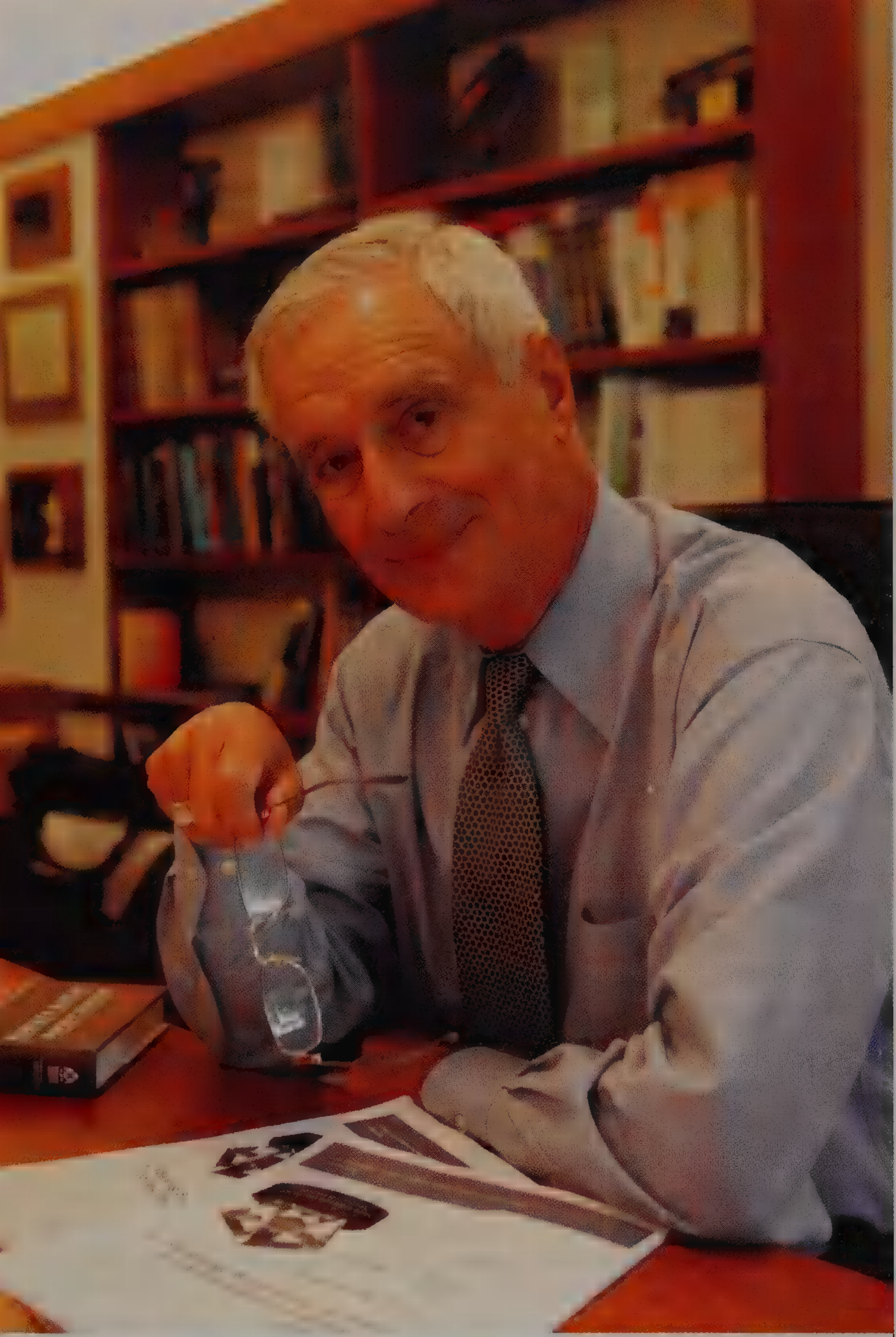
> The framework suggests that the CPA's integrity and competence may be appropriate safeguards in situations where the CPA lacks technical independence.

CONCLUSION

Recommendations from the Reliability Task Force, accompanied by anecdotal evidence from all stakeholder groups with an interest in compiled and reviewed financial statements of nonpublic companies, make clear the need for ARSC to consider modifications to the foundation underlying the compilation and review engagement technical literature. By embedding in that foundation a framework focused on financial statement reliability as the end game, ARSC could develop technical literature that accomplishes the overall objectives of serving the public interest and providing CPAs the guidance needed to perform compilation and review engagements. ❖

Exhibit 5 Attest Standards Proposal





Linking Strategy to Operations

Balanced scorecard and activity-based costing co-creator shares insights on evolution of management accounting tools.

Harvard Business School professor Robert S. Kaplan is co-developer of both activity-based costing and the balanced scorecard. In 2006, Kaplan was elected to the Accounting Hall of Fame, and received the Lifetime Contribution Award from the Management Accounting Section of the American Accounting Association. In 2008, the Institute of Management Accountants honored him with a Lifetime Award for Distinguished Contribution to Advancing the Profession of Management Accounting. The following is an edited transcript of a recent interview with the *JofA*.

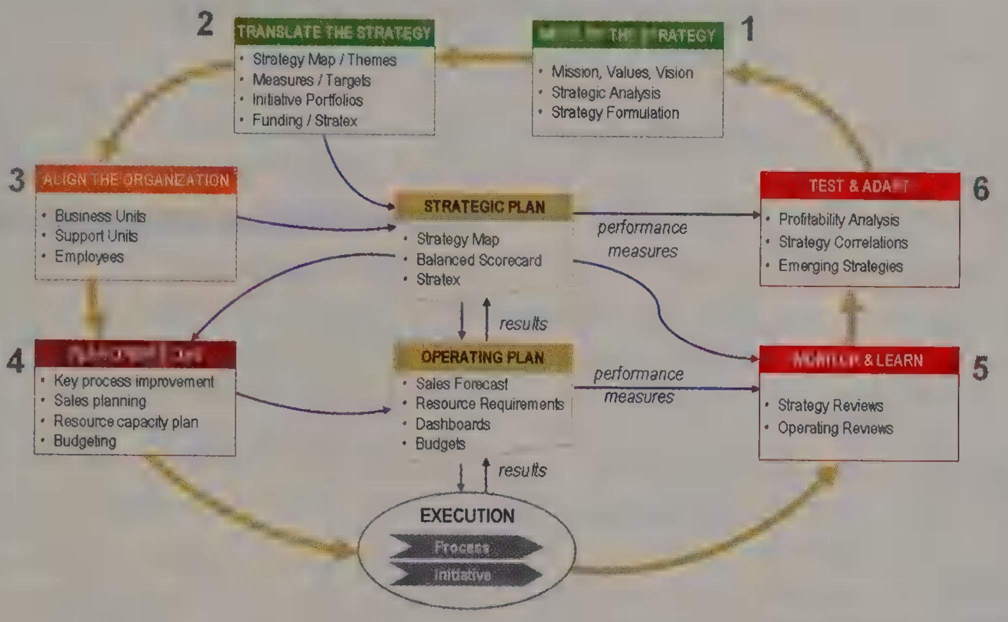
***JofA:** Could you give a summary of how you've come to work with activity-based costing and balanced scorecards?*

Kaplan: This journey started in the 1980s when I became exposed to the changes and innovations that were going on in management primarily through the Japanese management approach, which included total quality management and just-in-time inventory. And I realized that, if what I was hearing from practice was true, it undermined what we had been teaching and doing research on and actually practicing for the last 75 years. In effect, new approaches would be needed for both costing and performance measurement.

From that stage on, I started working on solutions. We found a few companies that had developed more accurate ways of assigning overhead costs to products and customers. That's how the activity-based costing (ABC) movement started. But even these improved financial metrics captured only what was happening with physical and financial assets, not the organization's intangible assets. The Japanese were gaining advantage through training and motivating their employees, improving the quality of processes, and working better

PHOTOS BY MIKE MALONEY/BLACK STAR

Exhibit 1 Closed-Loop Management System: Linking Strategy and Operations



with suppliers and customers—a whole set of performance capabilities that would not be picked up by periodic financial statements.

In 1990, David Norton and I developed the balanced scorecard (BSC), which retained financial metrics but supplemented them with metrics on the company's performance with customers, processes, and people and culture. This was an independent development from ABC, which addresses, "What are the costs associated with our existing processes, products and customers?" The balanced scorecard responds to, "Are we creating current and future value for our shareholders and customers?"

JofA: In the United States, how do you see the implementation of activity-based costing progressing?

Kaplan: I think there was a clear upsurge of interest starting in the mid-1980s when we introduced the concept. I detected a falloff in the late '90s and early part of this decade, just because the approach that we introduced ended up being too complex to implement.

People worried about subjectivity from people's estimates about their distribution of time, and it was difficult to keep the cost estimates up to date. Processes changed, and the cost of re-interviewing people was high. I think that ABC's use has gone down because people tried it, and it just proved too difficult. But I think the new approach, time-driven ABC, which Steve Anderson and I introduced, addresses these problems and makes ABC much more accessible and realistic for all enterprises.

> "I think the new approach, time-driven ABC ... makes ABC much more accessible and realistic for all enterprises."

Time-driven ABC works at the transaction and order level, and estimates directly the resource capacity (usually time) needed to process a transaction, build and deliver a product, and service a customer. It eliminates the need for subjective time estimates, which makes it easier to implement. And by directly linking processes to transactions, it is more flexible and accurate since variations in resource consumption can be readily modeled. ERP systems, which did not exist in the 1980s, now are widespread so the data for costing directly from transactions is now feasible.

Many accountants and finance professionals may not yet realize the simplicity and power of this new approach. They may remember that they tried ABC 10 or 15 years ago, and it didn't work out as advertised because of the difficulty of working from and maintaining employees' time estimates. The process time estimates used in time-driven ABC are much easier to obtain, verify and update as needed.

JofA: Has implementation of the balanced scorecard been similar to that of ABC?

Kaplan: I believe the adoption of the balanced scorecard has been much more widespread than even ABC. It addresses a fundamental issue that all enterprises, manufacturing and service, private sector and public sector, and nonprofit as well, face: how to describe, communicate and implement your strategy. We have established the Balanced Scorecard Hall of Fame that now includes more than 100 enterprises from all sectors and from countries all over the world that have used our philosophy to implement BSC and achieved performance breakthroughs. I do an informal survey in an executive program I teach at Harvard. Twice a year we get 160 executives, two-thirds of whom come from outside the U.S., for an eight-week program. This is pretty much a random draw from the world's managerial population. They're not coming to this program because I'm teaching the balanced scorecard; they're coming to spend eight weeks at Harvard.

I start the sessions by asking how many are using the balanced scorecard in some form in their organizations. Consistently, over the past eight years, 65% to 70% of

the hands go up. Not all of them may be following the principles that Dave Norton and I have been advocating over the last 10 years, but that still indicates the widespread adoption of the concept in some form.

> "We might talk about the finance function being transformed from bean counting and reporting to participating actively in value creation."

JofA: *In your most recent book,* The Execution Premium, *you introduce a six-stage closed-loop management system (see Exhibit 1). Does this system tie other management accounting tools such as ABC and balanced scorecards together?*

Kaplan: A *Harvard Business Review* editor has called the strategy execution management system my "theory of everything." It encompasses not only management accounting and control, but also quality management, beyond budgeting, strategy formulation, activity-based costing, analytics, operational dashboards and management by objectives. So it integrates a whole suite of management tools in a comprehensive and closed-loop system that links strategy and operations.

JofA: *In your closed-loop system, it appears that ABC is really an operations planning and monitoring tool?*

Kaplan: We describe how to use ABC for operational planning by having it forecast the levels of resource capacity—employees, equipment, space, technology—you need to supply in order to deliver on the revenue targets in your strategic plan. This is a powerful analytic tool that eliminates almost all of the guesswork, subjectivity and negotiations normally associated with the resource planning or budgeting process.

As the strategy is being executed, ABC monitors whether you're making money from your strategy—not in

AICPA RESOURCES

JofA articles

- "ABCs of Batch Processing," Aug. 07, page 40
- "Accountability by Numbers," June 03, page 61

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OTHER RESOURCES

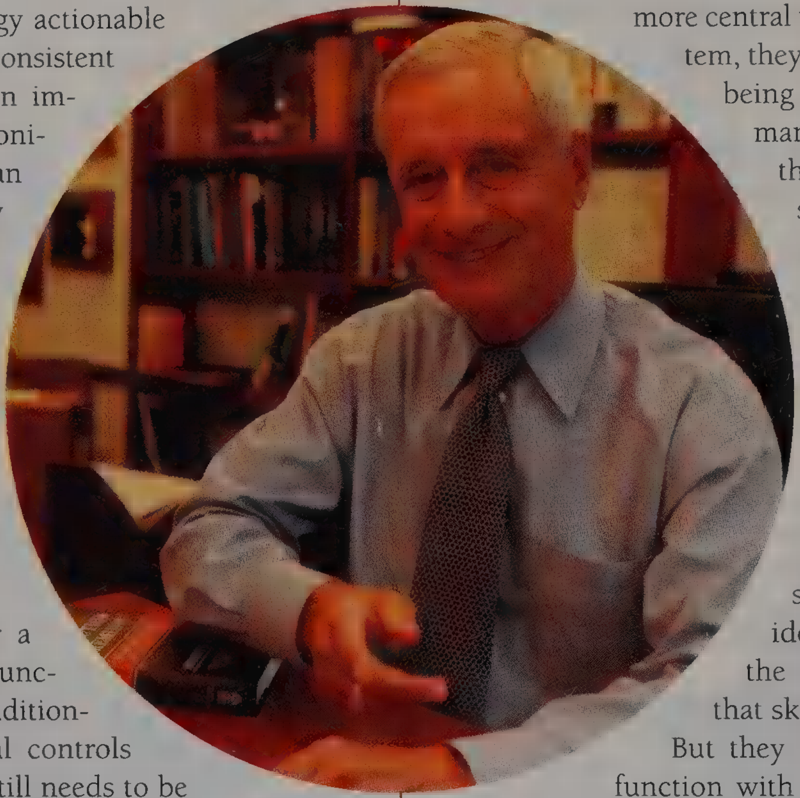
Books authored or co-authored by Robert S. Kaplan

- *The Execution Premium: Linking Strategy to Operations for Competitive Advantage*
- *Time-Driven Activity-Based Costing*
- *Alignment*
- *Strategy Maps*
- *The Strategy-Focused Organization*
- *The Balanced Scorecard: Translating Strategy into Action*
- *Implementing Activity-Based Cost Management*
- *Relevance Lost: The Rise and Fall of Management Accounting*

aggregate, financial statements do that—but product by product, by product line and also by customer-by-customer and by segment and channel. So the ABC system gives managers detailed feedback on where the strategy is working and where not, and greatly facilitates decisions managers can make to transform unprofitable operations into profitable ones.

JofA: *And the balanced scorecard is used both to translate strategy into operations as well as to monitor strategy?*

Kaplan: We are making strategy actionable and helping allocate resources consistent with the strategy. We make an important distinction between monitoring operations, which you can do with dashboards and key performance indicators, versus monitoring the strategy, which is the role for strategy maps and balanced scorecards.



JofA: *What do you see as the primary role for the finance organization inside this closed-loop system?*

Kaplan: We're advocating for a transformation of the finance function—we're not abandoning traditional financial reporting, internal controls and auditing because all that still needs to be done. But these should not be the only processes that the finance function does. In addition to the statutory compliance role, finance needs to play a role for value creation. We might talk about the finance function being transformed from bean counting and reporting to participating actively in value creation. Instead of just looking in the rearview window, the finance function can use tools such as activity-based costing, strategy maps and balanced scorecards to help the organization look through the front windshield and navigate to a profitable future.

The final chapter of *The Execution Premium* talks about a new office of strategy management. This office or function coordinates all the activities that go into the six-stage management system. We describe the roles and responsibilities for the strategy management office as well as where it should sit in the enterprise. The most natural place is likely within the finance function because finance is traditionally involved in planning, resource allocation, reporting, monitoring and evaluating. We have given the finance function a new and robust set of tools to help it guide the enterprise into the future. One can think of renaming the CFO to become the CVO, the chief value creating officer, or the CPO, the chief performance officer.

JofA: *For CPAs who haven't had a lot of experience up to this point with either activity-based costing or balanced scorecards, how would you recommend they go about learning this? Where should they start and what should their focus be in learning how to become an integral part of a closed-loop system like the one you describe?*

Kaplan: On the particulars of ABC and BSC, there are many articles, books and cases available that they can order. As far as having accounting and finance people become more central to the strategy management system, they'll have to get more comfortable being a business partner with the line managers and general managers, the CEOs. You can't just be the scorekeeper, sitting on the sidelines. You actually have to be part of the team. And that's probably a good place to start, is to become a more value-added partner of the team. You still need the finance function to be the corporate conscience or the corporate skeptic. Not all strategic ideas are profitable ideas or ideas worth doing, and the finance function has to retain that skepticism and control mentality. But they must complement the control function with a mind-set of helping the organization create sustainable value.

Accountants don't need to reinvent this stuff; these ideas now have been out about 20 years and there's been enough written about them that they should be able to do some reading or go to some courses to learn the fundamentals.

JofA: *How do you see the use of balanced scorecards and strategy maps and strategy execution and dashboards and budgets—the things that are in the center of this closed-loop system—evolving over the next five years or so?*

Kaplan: I think that our current knowledge about the effective use of strategy maps and scorecards now offers something uniquely valuable that no other approach can. The ability to describe your strategy, to measure your strategy, get feedback on your strategy—these are fundamental to business. All businesses need these capabilities, but until we formulated strategy maps and scorecards, they lacked the tools to accomplish them. I think that most people now recognize the limitations of attempting to manage competitive organizations with financial metrics alone. Financial metrics remain important, but they're not sufficient for guiding the success of the organization, and we now know how to fill the gap. ❖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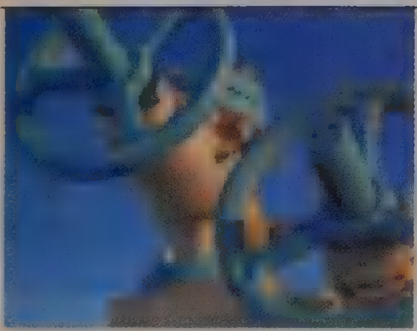

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TAX PRACTICE CORNER

Rules Clarified for Claiming the Exemption (and Related Tax Breaks) for Children of Divorced Parents

New final rules clarify who may claim qualifying children in the case of divorced or separated parents. Treasury Decision 9408, amending Treas. Reg. § 1.152-4, clarified the "counting nights" rule to identify a custodial parent.

In promulgating the final regulations, the IRS took into consideration comments of the AICPA (Aug. 8, 2007) and other professional groups. Although the rules specifically address exemptions, tax practitioners need to be aware of implications for the child credit, child care deduction, earned income tax credit, and head of household filing status. Future income tax rebates will also be affected if they are worded similarly to the Economic Stimulus Act of 2008.

Determining the Custodial Parent

Effective for tax years beginning after July 1, 2008, the exemption for a qualifying child of parents who are divorced, separated under a written separation agreement or who lived apart at all times during the last six months of the year goes to the custodial parent, regardless of what the divorce decree or written separation decree says, unless the noncustodial parent attaches a signed waiver effective for that tax year. The release of claim for an exemption must either be on Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, or a written declaration for the sole purpose of releasing the claim that conforms to the substance of Form 8332.

Where one or both parents have the right to physical custody for over one-half of the calendar year and the child is under the age of majority under state law, the parent with whom the child resides longer during the calendar year is the custodial parent. The child is deemed to reside with a parent using the counting-nights rule, where each night that a child (1) sleeps at the parent's residence, whether or not the parent is present, or (2) sleeps in the company of the parent when the child does not sleep at a parent's residence, such as when the parent and child are on vacation, is a night of residence for that particular parent. (In the case of a parent who works at night, a child resides with the parent based on greater number of days, not nights.)

Revocations of Release

A custodial parent has the right to revoke a previously signed release of claim by notifying the noncustodial parent in writing, using Form 8332 or a written document that conforms in substance to this form. Revocations cannot be retroactive; the earliest effective date for a revocation is the first calendar year after the custodial parent has reasonably attempted to notify the noncustodial parent. The revocation must be attached to the tax return of the parent revoking the release of claim for each year a revocation of a waiver is in effect and the qualifying child is claimed on the custodial parent's return.

Child Tax Credit and Other Breaks Follow

This regulation is important not only for the exemption deduction of $3,500 in 2008, but also for claiming the $1,000 per year child tax credit for each qualifying child under the age of 17. (Exemptions and child tax credits are subject to phaseouts for high-income taxpayers.) The child tax credit may also be claimed against alternative minimum tax and is refundable for certain low-income taxpayers. (For military service members, combat pay, which is normally exempt from gross income, is treated as earned income, often resulting in larger credits. Tax preparers also should review the HEART Act, enacted in June 2008, for additional military benefits.) Similarly, the HOPE scholarship and Lifetime Learning credits follow the exemption, not the custody of the child or the person paying the qualified education expenses. Currently, the maximum HOPE credit is $1,800 per student per year for the first two years of postsecondary education, and the maximum lifetime learning credit is $2,000 per student per year.

Both Parents Can Now Claim Dependent for Certain Expenses

In addition, the IRS in August issued Revenue Procedure 2008-48, which allows both parents who are divorced or separated to exclude from gross income certain deductions and exclusions on behalf of a dependent child, even if the custodial parent has not released his or her claim of an exemption for the child under section 152(e). They are: the itemized deduction for unreimbursed medical expenses under section 213(a), employee-provided medical expense reimbursements under section 105(b), employer-provided coverage under an accident or health plan under section 106(a), distributions from health savings accounts and Archer medical savings accounts, and certain fringe benefits that qualify as no-additional-cost services or qualified employee discounts under section 132(a). The revenue procedure is effective Aug. 18, 2008, but taxpayers may apply it to prior tax years still within the limitations period as of that date.

*By **Valrie Chambers**, CPA, Ph.D., associate professor of accounting, Texas A&M University–Corpus Christi. Her e-mail address is valrie.chambers@tamucc.edu.*

TAX MATTERS

NET LOSS CARRYBACK

ALL THAT GLITTERS IS NOT DEDUCTIBLE

The Tenth Circuit Court of Appeals upheld a district court's ruling that a company could not carry back a loss because the statute of limitations had passed.

Taxpayers that incur net operating losses are permitted under IRC § 172 to carry them back two years and forward 20 years. A carryback of 10 years is allowed for "specified liability losses," which include those arising from certain statutory environmental requirements of mining, oil drilling and nuclear power generation, specifically including land reclamation. Section 6511(d)(2)(A) limits the time for filing these amended returns to within three years of the due date of the return that had the net operating loss.

Gold mining company Barrick Resources had net operating losses in tax years 1997 and 1998. In 2001, the company timely filed amended returns for 1994 and 1995 carrying back the losses but without specifically explaining that they stemmed from land reclamation costs. In 2002, Barrick realized that part of the loss qualified for the 10-year carryback. It filed amended returns for 1991 and 1992 and received a refund. The following year, it filed yet another amended return for 1991 carrying back more of the reclamation costs from 1997 and 1998. The government denied this refund and demanded return of the earlier refund as paid in error. Both sides filed motions for summary judgment in federal district court in Utah.

Barrick argued that its 2002 and 2003 filings were not new claims but amendments of its 2001 amended return—like those the Supreme Court in *U.S. v. Andrews* (19 AFTR 1243 (1938)) and the Tenth Circuit in *U.S. v. Ideal Basic Industries* (22 AFTR2d 5438 (1969)) held were amendments or amplifications of pending timely refund claims and thus considered timely, even though the three-year period elapsed in the meantime. But, the district court held, and the Tenth Circuit affirmed, Barrick's claim was distinguished by not mentioning a specified liability loss in its 2001 amendments. The courts also rejected Barrick's contention that its designation of a "reclamation and closure" line item under "other costs" on its Schedule A of Form 1120X in that initial set of amended returns constituted sufficient notice of a specified liability loss for land reclamation.

The Tenth Circuit went on to reject the Eleventh Circuit's decision in *Mutual Assurance Inc. v. U.S.* (76 AFTR2d 95-5132). In it, the Eleventh Circuit allowed an extension to amend a refund claim that had already been paid. According to the *Barrick* court, the extension applies only to claims that are still pending.

Barrick illustrates that taxpayers cannot necessarily expect further amendments of pending refund claims to keep the statute of limitations open, especially if the reason for those amendments deviates from the original issues. Also, to take advantage of the 10-year carryback for specified liability losses, taxpayers must clearly invoke the provision, which also covers losses arising from product liability claims and workers' compensation payments.

■ *Barrick Resources (USA) Inc. v. U.S.*, 101 AFTR2d 2008-2656

*By **Edward J. Schnee**, CPA, Ph.D., Hugh Culverhouse Professor of Accountancy and director, MTA program, Culverhouse School of Accountancy, University of Alabama, Tuscaloosa.*

NET LOSS CARRYBACK

SHELL WINS $19M REFUND

A district court in Texas allowed Shell Petroleum to carry back capital losses and receive a nearly $19 million refund. The

Tax Costs Around the World

Ranking of selected countries by tax costs, including income, sales and payroll taxes, paid by corporations performing manufacturing, services, and research and development. The Total Tax Index uses the United States as a baseline of 100. For example, Mexico's total tax burden is 70.2% of what it is in the U.S.

		Total Tax Index
1	Mexico	70.2
2	Netherlands	78.3
3	Canada	78.8
4	Australia	95.9
5	United States	100.0
6	United Kingdom	101.6
7	Japan	120.8
8	Germany	128.2
9	Italy	172.0
10	France	185.3

Source: KPMG, *Competitive Alternatives 2008: Special Report: Focus on Tax*, available for free download at **www.competitivealternatives.com/download/default.asp.**

losses were generated by a restructuring transaction involving an exchange of high-basis property for new subsidiary stock followed by loss-generating dispositions of the stock.

In 1992, Shell Oil was facing serious financial difficulties. Oil prices had dropped significantly, causing serious declines in Shell's net income and net cash flow at the same time that its debt was increasing.

In reaction, Shell and its affiliated oil companies (the Shell Group) restructured to improve cash flow while preserving assets, especially offshore leases and oil shale rights that were currently nonproducing but that Shell thought could eventually yield profitable oil discoveries. (Shell had learned its lesson decades earlier, when it had abandoned its holdings on the North Slope of Alaska and the region then became home to the biggest oil field in North America.) The Shell Group transferred the properties to a new subsidiary, Shell Frontier Oil & Gas Inc., in a section 351 transaction. In such a transaction, shareholders receive a basis in the stock of the new corporation equal to the basis of the property they transfer to acquire that stock. In this case, the basis of much of the transferred property was far greater than its value. As a result, subsequent disposal of the stock in Shell Frontier created losses exceeding $350 million for tax year 1992. The Shell Group in 2004 carried back the consolidated net capital loss to 1990, which resulted in an overpayment for that tax year of $18.9 million.

The IRS disallowed these losses on various grounds. It claimed that since many of the transferred properties were nonproducing, they had no value and thus should not be considered section 351 property. However, the district court found that even though the properties were nonproducing, they did in fact have value and thus were considered property for section 351 purposes. Noting that the provision does not define "property," the court said Shell's interests "fit the classical—indeed, paradigmatic—definition of 'property' in that they are identifiable and transferable real property interests."

The IRS also asserted that the transfer was a sham transaction intended to artificially inflate tax basis. While the Shell Oil tax department was involved in the restructuring plan, it did not discuss any of the plan's tax benefits with management, so that the restructuring decisions would be based on economic factors. Among other things, this plan enabled the Shell Group to raise cash without jettisoning assets. The court found that the transaction therefore did have economic substance and that it was not tax-motivated and thus not a sham transaction.

Finally, the IRS asserted that it could reallocate the losses to Shell Frontier under section 482, which allows such reallocation between two or more entities owned or controlled by the same interests. The court, however, noted that the reallocation is provided "to prevent evasion of taxes," which it said was not the case with Shell. Courts have recognized the beneficial effect of tax-deferred exchanges under section 351 in encouraging the formation of new corporations and strengthening existing ones—all the more so, considering that when Shell undertook its transfer, the provision's allowance of a carryover of basis also enabled tax losses by both the transferee and transferor. Shortly before Shell filed its amended return, however, Congress plugged that loophole with the American Jobs Creation Act of 2004. For section 351 exchanges taking place after Oct. 24, 2004, such transfers of property with built-in losses require a reduction to fair market value of the basis of either the transferred property or the stock received for it.

Shell's 1990 tax year was open in 2004 because its original return was still under administrative appeal and it had waived the period of assessment. Under section 6511(c)(1) such a waiver also extends the period for filing a claim. The company said in an explanation accompanying its amended return that it had previously executed a Form 870-AD, *Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment*, reflecting an agreed overassessment for 1990 of nearly $128 million, not including the $18.9 million that was the subject of the claim.

■ *Shell Petroleum Inc. v. U.S*, 102 AFTR2d 2008-5085

*By **Karen M. Cooley**, CPA, MPA, instructor of accounting, and **Darlene Pulliam**, CPA, Ph.D., McCray Professor of Business and professor of accounting, both of the College of Business, West Texas A&M University, Canyon, Texas.*

INCOME AND DEDUCTIONS

EQUITABLE OWNER EQUALS DEDUCTION

The Tax Court held that a married couple could deduct mortgage interest and

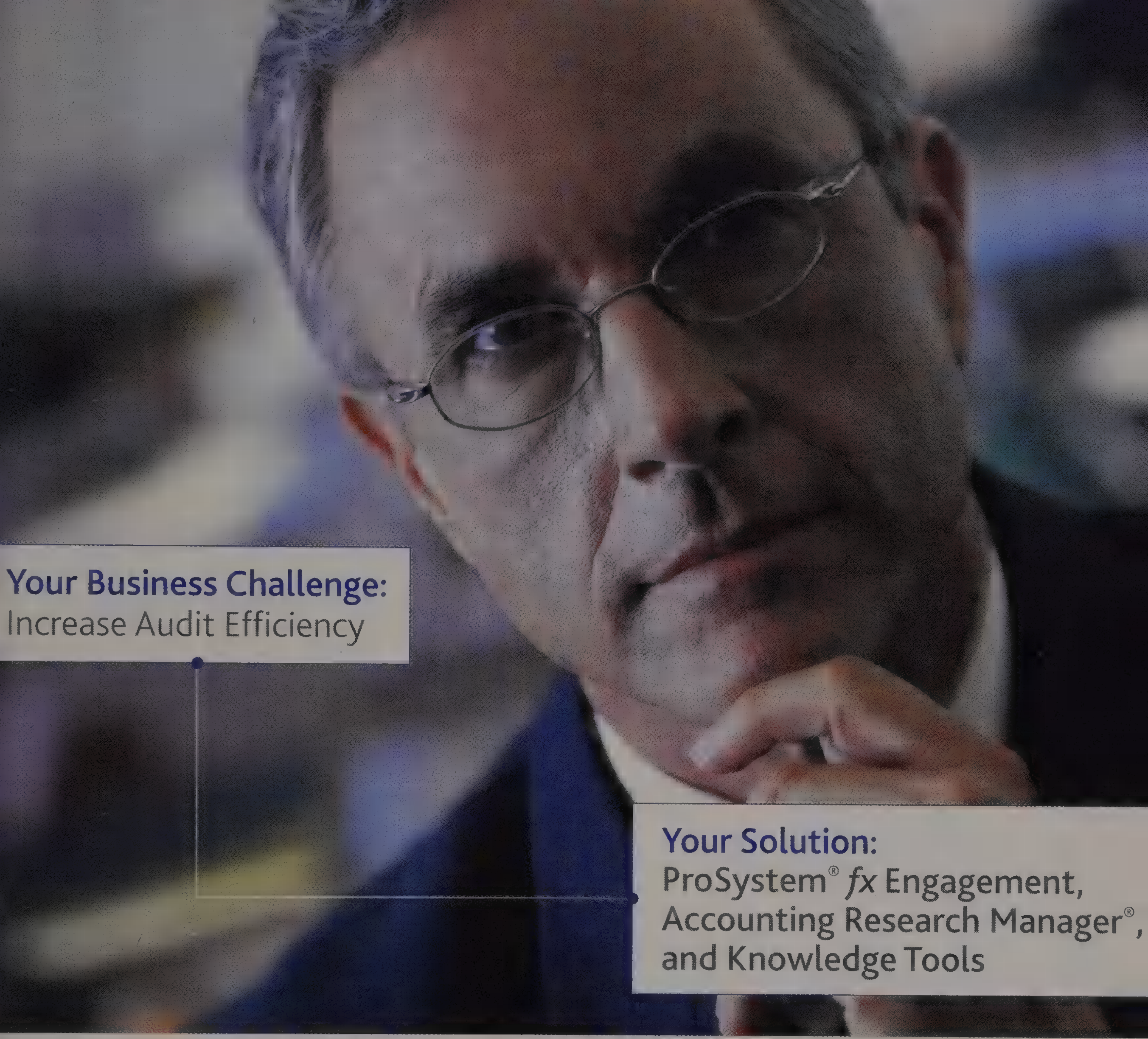
property tax payments made from a corporate checking account on a home that was owned by their son. The court held that the taxpayers were equitable and beneficial owners of the property and that the checking account was in essence their personal account. Thus they were entitled to itemized deductions for the payments.

Taxpayers may deduct interest paid by them on debt related to a qualified residence. Generally, the debt must be the taxpayer's, not someone else's. Treas. Reg. § 1.163-1(b) permits a deduction for interest paid on a mortgage when a taxpayer is the legal or equitable owner of the property, even though the taxpayer is not directly liable for the mortgage. In *Saffet and Ana Uslu v. Commissioner*, TC Memo 1997-551, the Tax Court held that a married couple was the equitable owner of a home titled to the husband's brother since, from the date of acquisition, they had occupied the home and made all payments for the mortgage, taxes, repairs, maintenance and improvements. In *Bruce D. Loria v. Commissioner*, TC Memo 1995-420, the same court held that the taxpayer was unable to demonstrate that he was the equitable owner of a home owned by his brother—thus denying deductions for interest and property taxes.

In the instant case, Ndile George Njenge and Ekinde Sone Nzelle Rachel resided in a home owned by their son. In 2001, their son purchased the home in his name since the taxpayers were unable to obtain financing; however, from the date of acquisition until the date of the trial, Njenge and Rachel made all of the mortgage, property tax and maintenance payments and were the sole occupants of the home. In 2003, the taxpayers paid those housing costs from a checking account of a company called Camrock General Engineering Co., an entity for which the taxpayers had established a bank account but never actually formed or started and did not intend to do so in the future. The IRS disallowed the mortgage and property tax deductions for 2003, causing the taxpayers to petition the Tax Court for relief.

The IRS argued that no deduction for interest and taxes should be allowed since Njenge and Rachel were not the legal owners of the property and were not legally obligated to make any payments. Furthermore, the IRS argued that Camrock had made the payments, not the taxpayers. The court rejected both arguments, holding Njenge and Rachel were the equitable owners of the property since, from the date of acquisition, the taxpayers were the only ones who enjoyed the benefit and bore the burden of the home. Furthermore, the court found that the Camrock checking account was in essence the taxpayers' personal account.

This case illustrates that the economic substance rather than the legal form of a home ownership situation can dictate the tax result. In this case, it is important to note that the taxpayers prevailed because the evidence suggested that their son was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owner in name only and that the "business," whose name was on the checking account used to make the housing payments, existed in name only.

■ *Ndile George Njenge and Ekinde Sone Nzelle Rachel v. Commissioner*, TC Summary Opinion 2008-84

*By **Charles J. Reichert**, CPA, professor of accounting, University of Wisconsin–Superior.*

EXCISE TAXES, TIMELY FILING

COURT HANGS UP ON PHONE TAX REFUND

The Court of Federal Claims held that the statute of limitations applies to taxpayers who paid the telephone excise tax through carriers and were not required to file returns related to it.

Until May 2006, the IRS contended that telephone toll charges that varied only with elapsed time but not distance were subject to the 3% federal excise tax. It had been instructing carriers to collect and remit the tax. Then the IRS conceded that time-only charges were not subject to the tax under IRC § 4252(b)(1) and set up a refund mechanism; however, Notice 2006-50 stated that only taxes collected for services billed between Feb. 28, 2003, and Aug. 1, 2006, were subject to refund.

RadioShack purchased long-distance service from carriers from Jan. 1, 1996, until July 31, 2006, and paid communications excise taxes on it. Because it paid the tax directly to its carriers and those carriers then remitted the tax, RadioShack was not required to file returns for it.

In October 2006, RadioShack filed a refund claim for the taxes paid during the first quarter of 1996. The IRS denied the claim because it was not filed within the period required under section 6511(a): "Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return" must be filed within three years of the return's filing or two years from when the tax was paid, whichever is later. RadioShack contended the statute of limitations didn't apply, since RadioShack was not required to file a return for the phone tax.

The Court of Claims disagreed. Holdings by three circuits including its own appellate authority suggest the provision would "effect a discriminatory exemption," the court said, if construed as literally as RadioShack asserted and in isolation from section 7422(a), which requires a properly filed administrative claim before any suit to recover tax paid. The court also cited *U.S. v. Clintwood Elkhorn Mining Co.* (101 AFTR2d 2008-1612; "Tax Matters: The Code Trumps Tucker," *JofA*, July 08, page 87) to note the Supreme Court recently underscored the "expansive reach" of the latter provision. In this case, the refund claim was filed approximately 10 years after RadioShack paid the taxes. Even claims for more recent tax years must be pursued within the limitations period, which means that for the estimated 94% of eligible corporate taxpayers who failed to claim a phone tax refund in tax year 2006, time is slipping away.

■ *RadioShack v. U.S.*, 101 AFTR2d 2008-2350

*By **Alice A. Upshaw**, CPA, MPA, instructor of accounting, and **Darlene Pulliam**, CPA, Ph.D., McCray Professor of Accounting, both of the College of Business, West Texas A&M University, Canyon, Texas.*

PARTNERSHIPS, PENALTIES

TAXPAYER IGNORES CPA'S ADVICE AT HIS PERIL

An owner of a California health care company was found liable by the Tax Court for an accuracy-related penalty for a deduction he claimed in spite of his CPA's advice against it.

Larry Wadsworth was a general partner of Gold Coast Medical Services (GCMS), which provided medical products and services to beneficiaries of the California Medical Assistance Program in 2001 and 2002. In 2003, the California Department of Health Services (CDHS) audited GCMS and found the company had engaged in "discriminatory billing." The state agency ordered the partnership to repay $2.3 million for the two years. Wadsworth and GCMS sought to amend their federal tax returns to reflect the repayment amount as a contingent liability, even though the company's appeal of the demand was still pending before the CDHS. Keith Borges, who the Tax Court noted is a CPA and member of the AICPA and California Society of Certified Public Accountants, had prepared the original tax returns for both the partnership and Wadsworth. After researching the request, Borges declined to amend the returns absent any supporting information or legal authority from Wadsworth. Instead of providing it, Wadsworth turned to an attorney representing GCMS in its appeal before the CDHS. The attorney then engaged a non-CPA preparer to amend the returns, resulting in more than $200,000 in tax refunds to Wadsworth for the two tax years. Meanwhile, CDHS granted GCMS's appeal and overturned the state's repayment demand. The IRS examined Wadsworth's amended returns and issued deficiencies in the amount of the tax refunds, plus accuracy-related penalties totaling $40,668. Wadsworth paid the deficiencies but contested the penalties.

The Tax Court ruled that the amended Schedule K-1 attached to the amended returns was not adequate disclosure to avoid the penalty, as the taxpayer argued. The court noted that it was not accompanied by Form 8275, *Disclosure Statement*, or other explanation of the basis of the changes. Moreover, the position lacked a reasonable basis as required by Treas. Reg. § 1.6662-4(e)(2)(i), the Tax Court said.

The taxpayer said he had elected a "modified cash" method of accounting but presented no evidence that the amount was paid. An accrual-method taxpayer would not be able to deduct a contested liability except under the conditions of IRC § 461(f), that is, having made a transfer to provide for the satisfaction of a liability that remained contested after the transfer. Moreover, the taxpayer lacked reasonable cause and did not act in good faith, the court found. "We find that Mr. Borges' refusal to amend the returns should have raised a red flag for petitioners, but petitioners disregarded that warning," the court said.

■ *Larry J. and Sherilyn Wadsworth v. Commissioner*, TC Memo 2008-171

*By JofA Senior Editor **Paul Bonner**.*


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SALES TAXES, NEXUS

ONLINE RETAILERS BATTLE N.Y. NEXUS

Online retailers Amazon.com and Overstock.com sued the New York State Department of Taxation and state officials over the state's new definition of Web sellers required to collect sales and use tax. New York changed the definition of vendors subject to the tax to include those who pay a commission or other consideration to a state resident who directly or indirectly refers in-state customers to the seller, including via Web link. The new law was enacted April 9 and applies to sellers doing more than $10,000 in business a year in the state. Sixteen days later, Amazon sued, followed by Overstock on May 30.

Amazon, the seller of books and other merchandise, allows "associates" who post a link to Amazon's Web site on their own Web sites to receive a percentage of purchases resulting from those "click-throughs." Discount goods seller Overstock, along with other online retailers such as Netflix and physical stores with online channels such as Wal-Mart and Office Depot, maintains a similar arrangement through an independent third party, LinkShare. Both Amazon and Overstock argued in pleadings for declaratory relief in the state supreme court that the new law violates the U.S. Constitution's Commerce Clause and the 14th Amendment and is overly broad and vague.

Both said their associates or affiliates are advertisers, not representatives performing solicitations. Despite New York mailing addresses for some associates, the companies said they have no way of knowing whether those associates reside in the state. Also, Amazon said, because the Web is unmoored from geography, "an advertisement on a New York 'resident's' website is no more likely to reach New York consumers than any other state's consumers."

■ *Amazon.com LLC v. New York State Department of Taxation and Finance*, docket no. 601247/08, N.Y. Supreme Court

■ *Overstock.com Inc. v. New York State Department of Taxation and Finance*, docket no. 107581/08, N.Y. Supreme Court

By JofA *Senior Editor* ***Paul Bonner***.

Line Items

HOUSING ACT TIGHTENS HOME SALE EXCLUSION

A revenue-raising provision of the Housing and Economic Recovery Act of 2008 enacted in late July (PL 110-289) disallows exclusion of gain from the sale of a principal residence under IRC § 121 attributable to periods the dwelling is used as a vacation or rental home or other nonqualified use. Nonqualified use is any use other than as a principal residence by the taxpayer, spouse or former spouse.

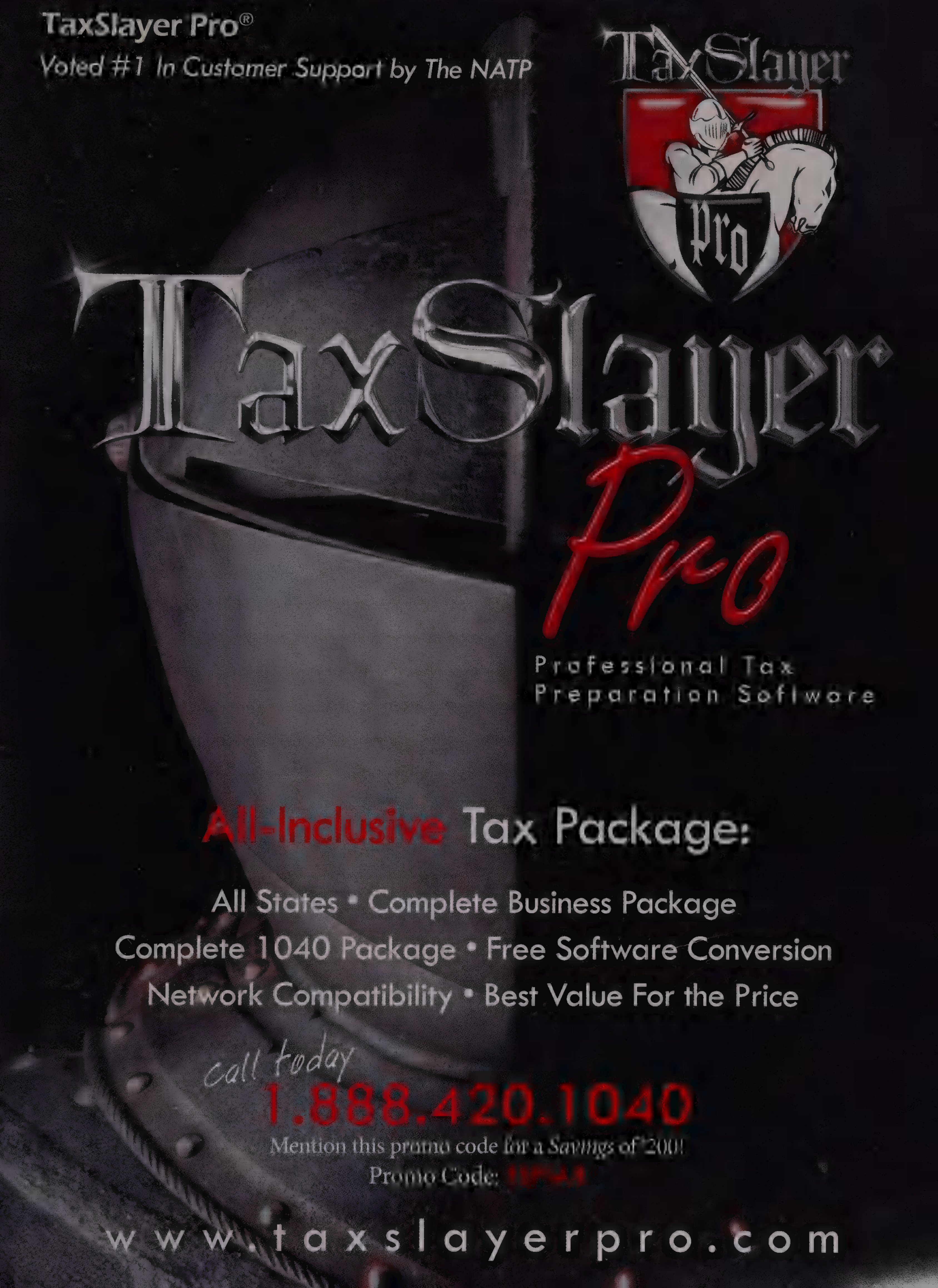
Section 121 allows exclusion of up to $500,000 in gain by joint filers ($250,000 for singles) on the sale or exchange of property that has been owned and used as the taxpayer's principal residence for at least two years out of the previous five. An exception to the new provision is allowed for periods after the home is no longer used as a principal residence by the taxpayer or taxpayer's spouse occurring within the otherwise qualifying five-year period preceding the sale. Exceptions also are provided for certain temporary absences of up to two years and those during extended military or other specified government service. The new provision, which would curtail or contraindicate some strategies described in previous *JofA* articles "Home Sweet Home," April 06, page 77, and "Home Free," Jan. 07, page 40, is effective for sales and periods of nonqualified use occurring after 2008.

Tax benefits introduced by the act include a temporary standard deduction for non-itemizers who pay real property taxes. Just for tax year 2008, the deduction is equal to the amount of real property tax paid, up to $1,000 for joint filers and $500 for singles. Also, a temporary first-time homebuyer credit is worth 10% of the home's purchase price, up to $7,500 for joint filers. Although the credit is refundable, it must be repaid over 15 years, making it in essence an interest-free loan. The credit begins to phase out at adjusted gross incomes over $150,000 for joint filers and is available only for homes purchased between April 9, 2008, and June 30, 2009.

GAO: BUSINESSES OWE $58B IN PAYROLL TAXES

Although payroll tax debts are one of the IRS's top collection priorities, the Service hasn't made optimal use of its enforcement tools against the 1.6 million businesses owing $58 billion for employees' income, Social Security and Medicare taxes, the Government Accountability Office said. Earlier GAO audits found that payroll taxes were a major component of tax debts owed by federal contractors (see "Tax Matters: Bills Target Contractor Scofflaws," July 07, page 84). In this follow-up study, the GAO found that although they are required to remit payroll taxes quarterly, some businesses allow them to accumulate for years, sometimes with little consequence. Seventy percent of unpaid payroll taxes were owed by businesses with more than a year's worth of unpaid payroll taxes, one-fourth by businesses that hadn't remitted them for more than three years.

Procedures designed to expedite enforcement of payroll taxes had the opposite effect when it came to liens, the GAO said. Such cases bypass the Service's Automated Collection System to go directly to a revenue agent in the field. But because of staffing constraints, those cases languish for "extended periods" while awaiting assignment, with no lien filed in 80% of cases examined. Even after the cases are assigned to an agent, liens are underutilized, the GAO said, citing previous internal studies by the IRS. Another potentially powerful enforcement mechanism is making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business owners and officers personally liable for the debt with a trust fund recovery penalty (IRC § 6672). But on average, the IRS took two years after assessing a tax debt to impose the penalty. Meanwhile, business owners in some cases continued to accumulate payroll tax debt, often along with other tax-abusive and even apparently criminal activities (besides the federal felony of willful failure to remit payroll taxes), the GAO said.

Besides potentially leaving employees holding the bag for nonwithheld income taxes, nonpayment of FICA for assessments issued as of Nov. 1, 2007, required the government to transfer $44 billion from general funds to the Social Security and Hospital Insurance trust funds, the GAO said.

CAR 54, WHERE ARE YOU?

Police officers and firefighters who are permitted to drive their official vehicles home are exempt from the arrangement's being considered a fringe benefit includable in income or subject to substantiation requirements of IRC § 274(d)(4), since the vehicles are considered unlikely to be used for personal purposes more than a minimal amount. In June, the IRS issued proposed and temporary regulations widening the provision to encompass vehicles used by "public safety officers," which include law enforcement officers, rescue squad workers, ambulance crew members and chaplains who serve a governmental unit or agency in an official capacity. A public safety officer may be paid or unpaid, but vehicles must be clearly marked by insignia or words. See REG-106897-08.

GRAT EXPECTATIONS

The Service adopted final regulations governing inclusion in estates of trust property of grantor retained trusts, charitable retained trusts and similar trusts. The final regs (TD 9414) are effective for estates of decedents dying after July 13, 2008, and modify and clarify a number of features of their proposed version issued the previous summer. Provisions relating to the application of IRC § 2036, *Transfers With Retained Life Estate*, on grantor retained annuity trusts and grantor retained unitrusts have been clarified. Revenue rulings 76-273 and 82-105 have been superseded.

STARTUP EXPENSING ELECTION NOW DEEMED

Taxpayers may elect under IRC § 195 to deduct in the first year of operation up to $5,000 of startup expenses (reduced by the excess of total startup costs over $50,000) of an active trade or business and generally must amortize the remainder over 15 years. In July, the IRS issued final, temporary and proposed regulations allowing the election to be deemed rather than made formally. Since 2004, enterprises were required to file a separate election statement such as Form 4562, *Depreciation and Amortization*. But effective Sept. 6, 2008, they are considered to have made the election unless they clearly elect to capitalize the costs. See TD 9411.

HEALTH ACCOUNTS ILLUSTRATED

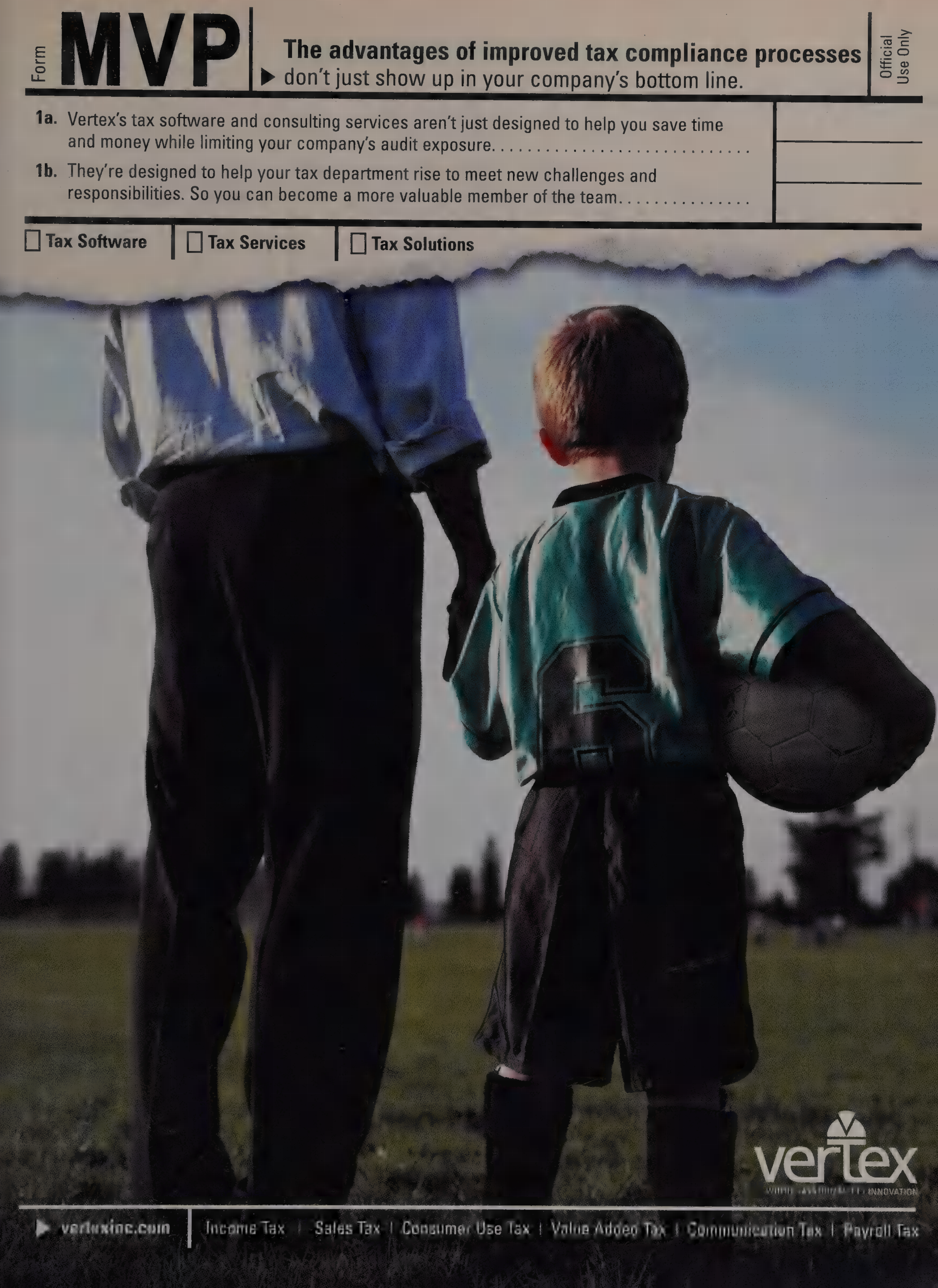
The IRS has provided guidance on a variety of issues pertaining to health savings accounts (HSAs). The 42 questions and answers of Notice 2008-59 address such issues as eligibility for individuals with "limited purpose" coverage by a health flexible spending account (FSA) or health reimbursement arrangement (HRA). The guidance also covers eligibility for an HSA when an accompanying high-deductible health plan features both a family, or "umbrella," deductible and an embedded individual deductible. If a limited-purpose FSA or HRA covers post-deductible expenses above the individual, but below the umbrella, deductible, an individual can still remain eligible for an HSA.

AICPA TO WEBCAST SEMINARS ON NQDC, AMT

A Web seminar, "Nonqualified Deferred Compensation Under Section 409A: Implementation Roundtable," will be held Oct. 2 from 2 to 4:30 p.m. ET. Tax, PFP and PCPS section members may participate free or may pay a discounted price of $74 and receive 2½ hours of CPE credit (non-section members pay $99). Register for the free program at **http://tinyurl.com/5u5jwb**, or for CPE, log on to **www.cpa2biz.com**, go to "Web Events," and the section discount will automatically be applied at checkout.

Eddie Adkins, from Grant Thornton, and Helen Morrison, acting deputy benefits tax counsel at the Treasury Department, will use a case study and practical examples to provide an overview of the NQDC rules and actions required by the end of 2008. In addition, Karen Field, from KPMG, and Deborah Walker, from Deloitte & Touche, will help answer questions, which may be posted throughout the session.

Then, on Oct. 27 from 2 to 3:30 p.m. ET, the Tax and PFP sections of the AICPA will present "AMT: Strategies to Escape Its Reach." Joseph W. Walloch of the Walloch Accountancy Corp. of Redlands, Calif., and Norman Solomon of La Jolla, Calif., will moderate the session. Walloch also chairs the Tax Section's Individual Income Tax Technical Resource Panel. This webcast will cover planning strategies, recent court cases, guidance and legislation, with a focus on planning for investment expenses, income and property taxes, legal expenses, capitalization and miscellaneous itemized deductions. Go to **http://pfp.aicpa.org** and click on "Web Seminar Series" to register. ❖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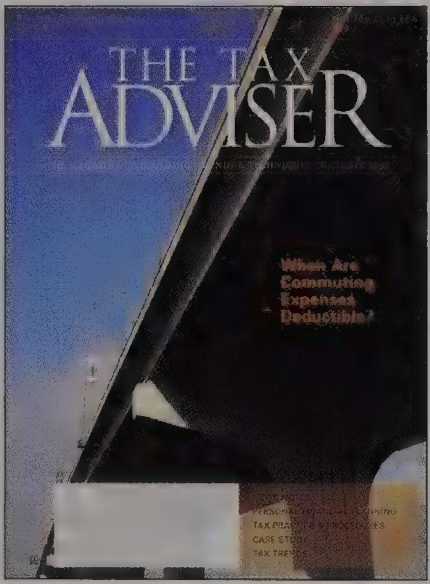
AVOIDING THE SECTION 72(t) PENALTY

Substantially Equal Periodic Payments From an IRA

In the current economic climate, unexpected circumstances may cause many individuals to consider the early withdrawal of IRA funds. Minimizing the tax consequences of these withdrawals requires careful consideration of opportunities to avoid the 10% penalty on premature distributions.

While all distributions from a traditional IRA are subject to income tax under the annuity rules in IRC § 72, an additional 10% penalty is imposed by section 72(t) on the taxable portion of distributions occurring before the owner reaches age $59\frac{1}{2}$. The IRA owner can avoid this penalty if specific exceptions apply.

For example, the penalty does not apply to withdrawals due to the owner's death or disability. Distributions for qualified medical expenses, qualified education expenses, first-time home purchases, and health insurance premiums paid by the unemployed, as well as qualified hurricane distributions and qualified reservist distributions for the military, are all exempt from the penalty (subject to certain requirements). Distributions that are part of a qualified series of substantially equal periodic payments (SEPPs) made annually to the IRA owner are also exempt from the penalty.



SEPPs

Of all the exceptions to avoid the early distribution penalty, the substantially equal periodic payment (SEPP) alternative is the most universally available. It does not rely on pre-existing conditions such as medical or educational expenses and is available to any IRA owner who is willing to calculate and sustain withdrawals according to the rules specified by the IRS. Thus it provides an opportunity to fund early retirement or meet payments on long-term debt obligations without the imposition of the penalty. This can mean substantial savings on large IRA withdrawals.

DEVELOP A STRATEGY

The IRS provides several safe-harbor methods for calculating the SEPP amount. Some factors are subject to the taxpayer's discretion and may be used to adjust the payment to a preferred amount and still avoid the premature distribution penalty. Using these factors to establish the SEPP amount in response to the IRA owner's objectives requires making choices at the beginning of the payment series.

For example, a client wishing to meet short-term financial needs with IRA distributions may prefer to maximize the SEPP withdrawal over the shortest possible period. This objective would be met by choosing among several approved formulas, interest rates, and life expectancies to calculate the maximum payment.

However, if the objective is to fund a long-term commitment such as early retirement, the client may prefer to limit the payment amount to extend the series over a lengthy period. In this case the same factors could be used to maximize the distribution period. Strategic choices made in establishing the SEPP will permit the IRA owner to exercise some control over the amount to be received consistently over the payout period.

For a detailed discussion of the issues in this area, see the article by Linda Burilovich and Andrew Burilovich, "Substantially Equal Periodic Payments from an IRA," in the October 2008 issue of *The Tax Adviser.*

—Alistair M. Nevius, editor-in-chief
The Tax Adviser

Also look for articles on the following subjects in the October 2008 issue of *The Tax Adviser*:

- A discussion of deductible commuting expenses.
- A look at recent S corporation developments.
- An examination of how to terminate partnership interests.

Technology Q&A

by Stanley Zarowin

Staying with XP? Keep it in tiptop shape…Block editing a memo's text so only Track Changes comments can be added…Stop Outlook from "disappearing" when switching to the desktop…Hiding cells in Excel–just one or two or even 100 at a time…A better idea

STAYING WITH XP? KEEP IT IN TIPTOP SHAPE

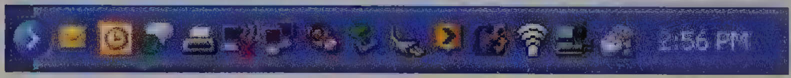
Q I've decided to forgo the move to Vista and stick with XP. My plan is to wait patiently until Microsoft comes out with the next operating system update. Do you have any advice for keeping my aging XP in tiptop shape?

A You're not alone in deciding to stay with XP. Because we don't know how long it will take before Windows 7 (Microsoft's code name for the anticipated next version) will appear, you're wise in seeking ways to keep your XP from developing geriatric aches and pains. Here are several things you can do to keep it in prime condition:

- Unlike much in technology, the latest iteration of a software product is not always the best, and when it comes to operating systems (OS), there is a further complication: Older systems were designed to work with older applications that use older device drivers. So if you start loading new apps and drivers to your XP, there's a risk that it is going to start developing indigestion and, worse, crashing. My advice is to avoid updating those apps. In short, if it ain't broke, don't fix it.

  What if you must update a printer or even buy a new one that's designed for Vista (because there is no longer an XP-compatible model available) and problems develop? I suggest you contact the manufacturer and explain that you're using XP and you need compatible drivers. Vendors are becoming aware of this need and in most cases will help you. You can also do a Google search, identifying the target product; it will either take you directly to the appropriate vendor's site or many Web sites that stock a wide variety of drivers and allow you to download them for free.

- Antivirus and spyware software are the exception to the above rule. Keep them up to date.
- When adding new hardware (memory, processor) confirm with the vendor that the product is compatible with XP. Again, vendors are aware that many customers are sticking with XP, and they are making adjustments.
- Think lean. Old systems tend to accumulate clutter—especially those programs that want to start up with Windows. Each one grabs some memory, putting a drag on your system. For a graphical spotlight on those auto-start apps, check the icons to the left of your clock. And if you want to see more, click on the left-facing arrow and a bunch will probably pop into view (see screenshot below).



There are many ways to locate and disable apps you don't really need. Microsoft offers a free tool, AutoRuns for Windows, that does an excellent job. You can download it at **http://technet.microsoft.com/en-us/sysinternals/bb963902.aspx**. It not only identifies each auto-start app, it also gives you the option to disable it—at least until you may need it later.

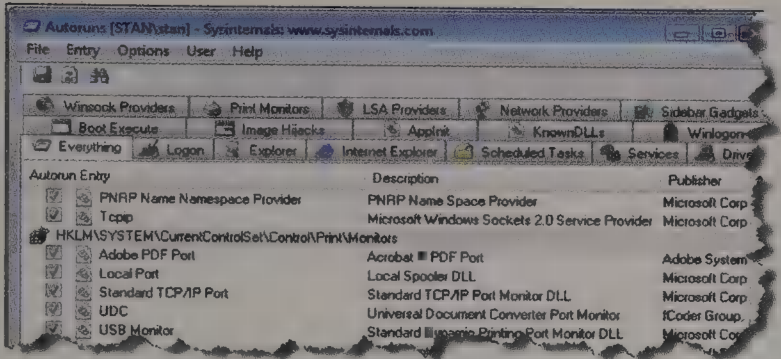
Don't be intimidated by the huge number of apps listed by AutoRuns for Windows (see screenshot at the top of the next page), and don't worry that you can't identify many of them. Start with the ones you know you don't need, reboot, and see how well the computer runs. If it's OK, disable the ones you suspect are unnecessary and repeat the process. If you've disabled one that you subsequently discover you need, just go back and enable it by adding a check next to it. It's not rocket science—but it takes patience.

» Key to Instructions

To help readers follow the instructions in this article, I use two typefaces:

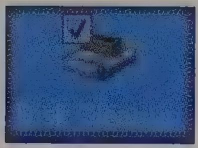
Boldface *type is used to identify the names of functions, menu items, icons, agendas and URLs.*

Sans serif *type indicates the names of files and the names of commands and instructions that users should type into the computer.*

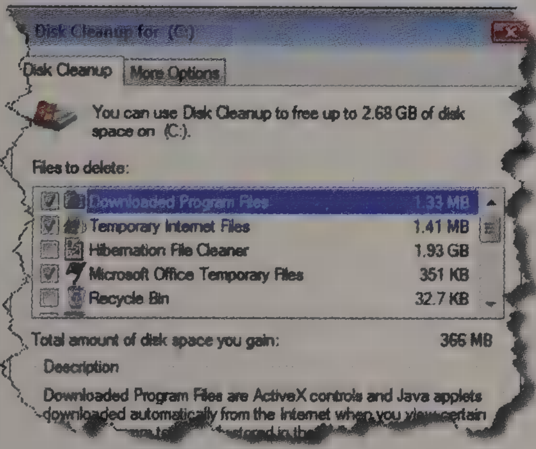


■ XP's **Hibernation** feature, as good as it is for saving power, has a major downside: It's a RAM gobbler, and certainly you can live without it. You can disable it by clicking **Start**, **Run**, typing powercfg.cpl, clicking the **Hibernate** tab, unchecking **Enable hibernation** and clicking **OK**.

■ Another source of clutter are Windows junk files. For a thorough sweep, run the Windows **Disk Cleanup** tool. To access it, click on **Start**, **All Programs**, **Accessories**, **System Tools**, **Disk Cleanup**. If you can't find it there (some older XP operating systems are set up slightly differently), go to C:\Windows\system32\cleanmgr. To access it easily in the future (you should run it at least once a week), make a shortcut and drag the icon to your desktop.



Disk Cleanup also can remove outdated restore points created by **System Restore**. To do that, click the **More Options** tab, and under **System Restore** click **Clean up** and confirm that you want to delete all but the current restore point (see screenshot below).

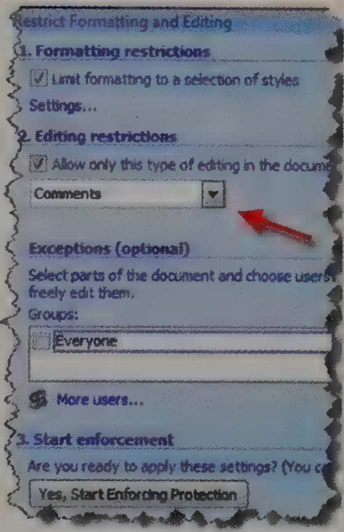


■ And to keep the data on your hard drive stored most efficiently, be sure to defragment at least weekly. To access the Windows defrag tool, go to **Start**, **All Programs**, **Accessories**, **System Tools**, **Disk Defragmenter**. You might want to put that tool on your desktop for easy access, too.

BLOCK EDITING A MEMO'S TEXT SO ONLY TRACK CHANGES COMMENTS CAN BE ADDED

Q In the August column, in "Put a 'lock' on Track Changes" (page 94), you described how to block anyone from erasing someone else's comments in Word's **Track Changes**. However, I want to block people from messing around with the text of my memos. If they have a comment or suggested change, I want them to use **Track Changes**—and keep their hands off the text of my memo. How can I do that?

A Follow the same steps listed in August's item—only this time, in the dropdown list under **Editing Restrictions**, select **Comments** (see screenshot at right) and you've created an effective barrier.

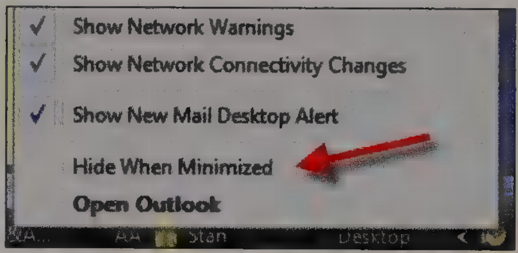


STOP OUTLOOK FROM "DISAPPEARING" WHEN SWITCHING TO THE DESKTOP

Q I usually keep Outlook open all the time. That assures I'll get all my e-mails promptly. But the other day I realized that every time I clicked on the **Show Desktop** icon in my taskbar, Outlook closed the moment the desktop appeared. I don't think I did anything to make that happen, but it sure is annoying. Can you help?

A Actually, Outlook was not closed when the desktop appeared; it was only minimized. If you look on the right side of your taskbar, next to the time, you'll see several icons, and one of them will surely be Outlook (see screenshot above).

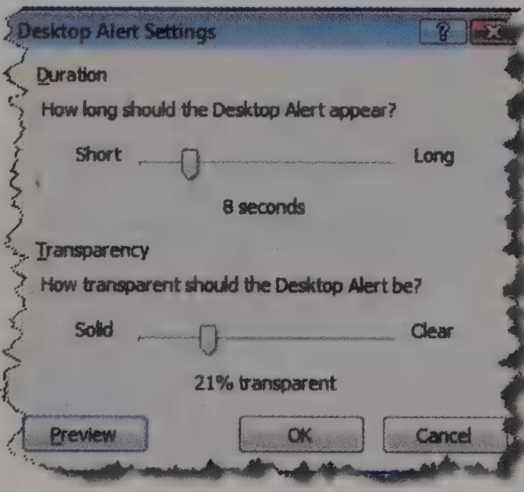
To solve the problem, right-click on that icon, and this menu will appear:



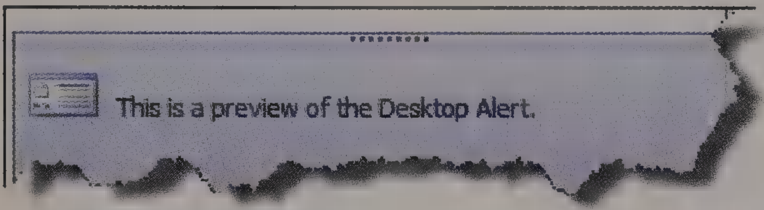
Just remove the check next to **Hide When Minimized**, and Outlook will not minimize when you click on **Desktop**.

I would guess you accidentally clicked on that item when you were making some adjustments in your taskbar.

Bonus tip: Whether it's minimized or not, how would you like to get a discrete notice whenever you've got new mail? With a simple setup adjustment in Outlook, such a notice, which includes the name of the sender and the subject, will appear on your screen no matter what you're doing on the computer. To set it up in Outlook, go to **Tools**, **Options**, **Preferences**, **E-mail Options**, **Advanced E-mail Options**, **Desktop Alert Settings**, which will bring up the screenshot at left.



Notice you can control how long the alert remains on your screen and the message's opacity; making it slightly transparent (see screenshot below) allows you to read any data covered by the alert screen.

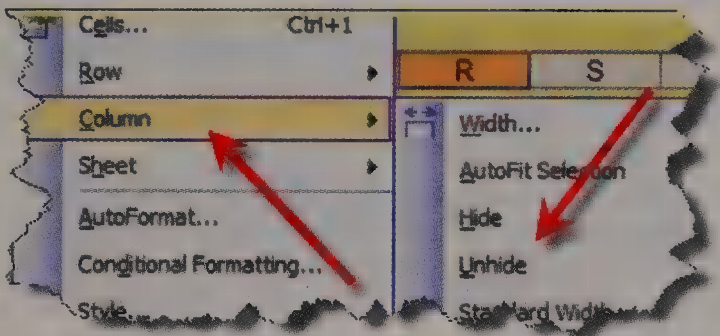


HIDING CELLS IN EXCEL—JUST ONE OR TWO OR EVEN 100 AT A TIME

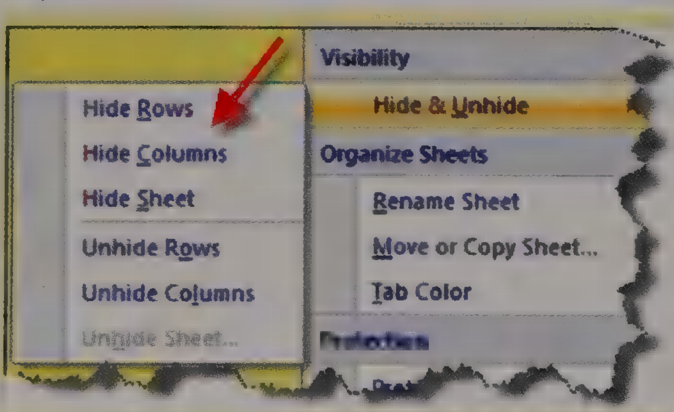
Q I often deal with very large worksheets with a massive ocean of data-filled cells. In an effort to make the worksheet easier to view, I try to hide cells that are not essential. While it's easy to hide whole columns and rows—and even a whole page—I can't figure out how to hide just a few or maybe even some that are not contiguous in a row or column. Mind you, although I want them visually out of the way, I want the data in the hidden cells to continue to calculate as if they were not hidden. Any suggestions?

A You're right, Excel does not excel when it comes to hiding individual cells, and Excel 2007 is no better than 2003. While there are several ways to do it, all require multiple steps and are not flexible. The major tool to use is **Format**. It's good at hiding whole columns and/or rows—and, yes, even a whole page—but when you want to hide individual cells or groups of cells, you have to go through some gymnastics.

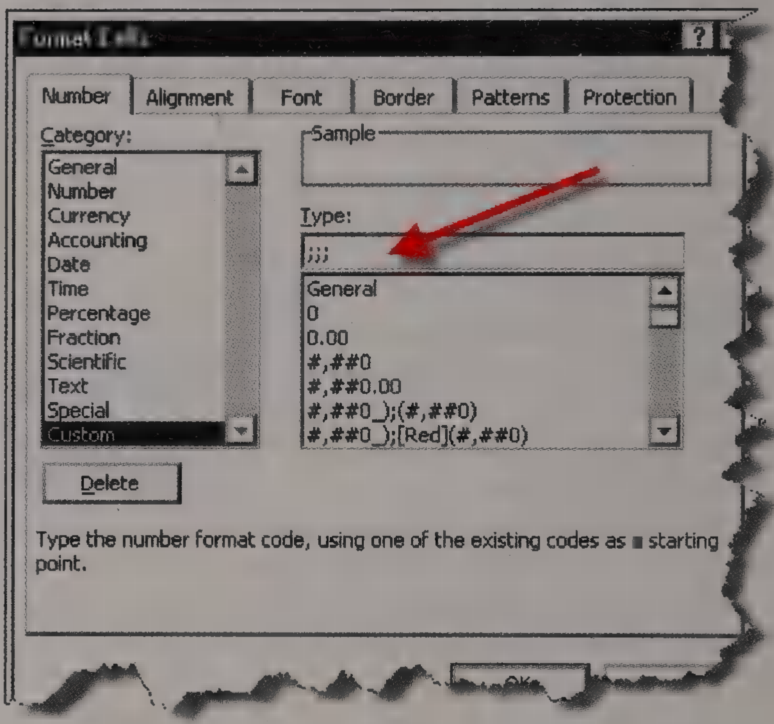
Here, for example, are your limited choices when you evoke **Format** in Excel 2003…



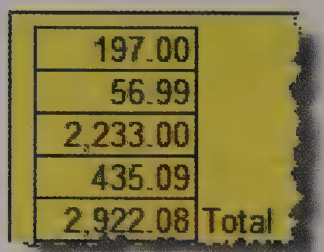
…and this in Excel 2007 (**Format** is in the Home ribbon).

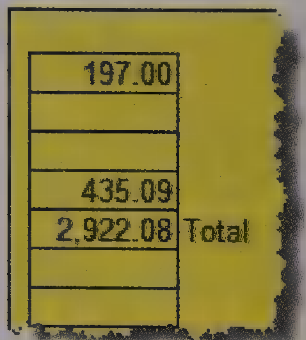


Here is how to get around that whole-column or whole-row obstacle in both Excel 2003 and 2007: Highlight the cells you want to hide; to highlight noncontiguous cells, hold down the Ctrl key as you highlight them in sequence. When finished, press Ctrl+1 to evoke the **Format Cells** screen, click on the **Number** tab, go down to **Custom** and in the **Type** box select three semicolons (;;;) and then **OK** and, presto, the cells are hidden (see screenshot below).



As you can see in the screenshots below, even when I hide two cells (56.99 and 2,233.00), the Total remains the same.





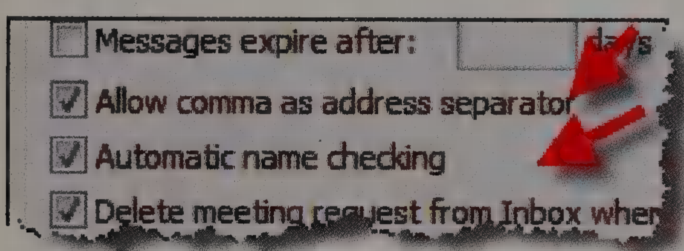
A bonus: If you're seeking a hiding-cells shortcut, here's an unpublished tip for quickly hiding whole rows and columns without taking your fingers off the keyboard (except to select the cells).

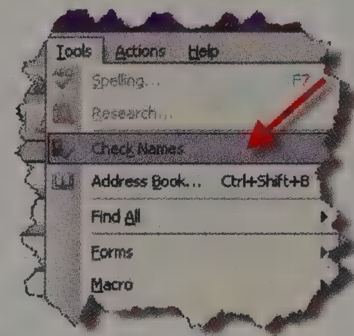
The sequence: For rows, highlight the cell (or cells) in the row (rows) you want to hide, and press Ctrl+9. To reverse the process, press Ctrl+Shift+(. You'll notice that the open parenthesis and the number 9 share a key, so holding down Shift evokes the open parenthesis. For columns, it's the same process, only use the 0 (zero) key and the close parenthesis.

A BETTER IDEA

An article in the June column (page 104) suggested a fast way to create an e-mail distribution list in Outlook from a column of addresses in a spreadsheet. Bryan Caston, an Exchange engineer with AT&T who reads the technology section of his CPA wife's copy of the *JofA*, suggests a way to accomplish the task without transposing the Excel list or inserting semicolons between the e-mail addresses.

Copy a column of e-mail addresses from your spreadsheet and paste it into Outlook's **To**, **Cc** or **Bcc**. Although Outlook will automatically format the addresses after a short delay, you can speed the process by changing a default: Go to **Tools**, **Options**, **Preferences**, **E-mail Options**, **Advanced E-mail Options** and be sure a check is next to **Allow comma as address separator** and **Automatic name checking** (see screenshot below).





You also can trigger the action immediately by pressing Ctrl+K, or, in some copies of Outlook before 2007, there is a **Check Names** function under the **Tools** menu (see screenshot at left).

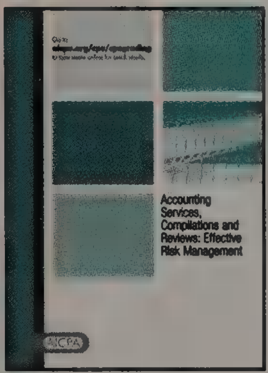
And in Vista you can find a **Check Names** icon in the **Message** ribbon. ❖

***Stanley Zarowin** is a contributing editor to the* JofA. *His e-mail address is stanley.joatech@gmail.com.*

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to me via e-mail at stanley.joatech@gmail.com or via regular mail at the *Journal of Accountancy*, 220 Leigh Farm Road, Durham, NC 27707-8110.

Because of the volume of mail, I regret I cannot individually answer submitted questions. However, if a reader's question has broad interest, I will answer it in a forthcoming Technology Q&A column.

AICPA marketplace 2008



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AICPA Member **$135.00**

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- Identify the risk management practices available

Value Aid! AICPA Peer Review Checklists
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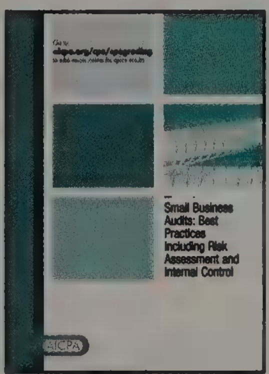
NASBA Field of Study: Auditing
Prerequisite: Experience in accounting services, compilations and reviews



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Small Business Audits: Best Practices Including Risk Assessment and Internal Control

The auditor in today's world is constantly under scrutiny whether the client is large or small. However, small businesses bring a unique set of issues for auditors trying to balance risk, effectiveness and efficiency. Recognize risk in the small business environment and how to deal with it effectively and efficiently from audit planning until the wrap up.

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- Conduct analytical procedures and audit testing effectively for the small business audit

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Recommended CPE Credit: 12
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Inside AICPA

Two named Outstanding CPAs in Government...
Teacher earns Special Recognition Award...AICPA announces Elijah Watt Sells winners...
Institute awards management accounting research grants

Kurt Kawafuchi (left) and Robert Scott

GOVERNMENT CPAs NOTED FOR IMPROVEMENT PROGRAMS

Kurt K. Kawafuchi of Honolulu and Robert B. Scott of Carrollton, Texas, received the AICPA's 2008 Outstanding CPA in Government Award.

The awards recognize CPAs working in state and local government who made significant contributions to increased efficiency and effectiveness of government organizations and to the growth and enhancement of the profession.

Kawafuchi received the state government award. Scott received the local government award.

The awards were presented at the AICPA's 25th Annual National Governmental Accounting and Auditing Update Conference in Washington, D.C.

Kawafuchi, director of the Hawaii Department of Taxation, streamlined the department's operations by implementing one-stop taxpayer support, faster refunds, "plain English" correspondence, automated 24/7 phone support, improved implementation of legislative changes, and audit selection tools. These programs and others have helped generate a record $304 million in collections over a previous record of $113 million.

Scott is Carrollton's CFO and assistant city manager. He is credited as a champion of change for the Texas Municipal Retirement system, which covers state employees in more than 800 cities. He has assisted Texas governments in implementing GASB's new standards on other post-employment benefits by coordinating a share actuarial services contract through the local Council of Governments, allowing governments of all sizes to access high-quality actuarial services for reasonable prices.

TEACHER RECOGNIZED FOR CONTRIBUTION TO ACCOUNTING EDUCATION

Martha Collins Scarberry, an accounting teacher at Madison Southern High School in Berea, Ky., received the AICPA's 2008 Special Recognition Award.

The award, given to an individual who has performed or contributed significantly to the success of a particular project or initiative that benefits the profession, was pre-

Martha Collins Scarberry and Randy Fletchall

sented at Interchange 2008, a professional staff development conference coordinated by the AICPA and the CPA/Society Executives Association.

Collins Scarberry, a member of the Kentucky Accounting Foundation's Curriculum Task Force, wrote *Accounting and Finance Foundations I* and helped develop the curriculum guide *Accounting and Finance Foundations II*. Those texts evolved into new accounting courses that replaced Kentucky's original 1930s-era curriculum. As a result, the Kentucky State Board of Accountancy and the Kentucky Society of CPAs secured $125,000 of surplus state board funds to earmark for teacher training in 200 of the state's schools.

EXAM HIGH-SCORERS ANNOUNCED

The AICPA announced the winners of the 2007 Elijah Watt Sells Awards, presented annually to the 10 candidates earning the highest cumulative scores on the four sections of the Uniform CPA Examination. In 2007 more than 76,000 candidates took the exam. The winners, in alphabetical order followed by their state board affiliation, and the school from which they graduated, are:

Steven J. Alden (Mass.),
University of Massachusetts-Amherst
John G. Berger Jr. (Ill.),
University of Notre Dame
Jason J. Brancazio (Calif.),
Princeton University
Bryan E. Dean (Wash.),
University of Washington
John Briscoe Escosa III (Ky.),
Bellarmine University
Rapheal Joseph Hamilton (Kan.),
Emporia State University and Syracuse University
Wenxin Li (N.H.),
Shanghai Jiao Tong University in China
Barri Alexandra Litt (S.C.),
University of Florida-Gainesville
Walker Fleming Saik (N.C.),
Davidson College
Bryce A. Schonberger (Colo.),
University of Colorado-Boulder

The award honors Elijah Watt Sells, one of the country's first CPAs and a leader in advancing professional education.

PROFESSORS RECEIVE GRANTS FOR MANAGEMENT ACCOUNTING RESEARCH

The Institute awarded research grants for 2008–2009 to accounting and management professors Barry Mishra and Erik Rolland of the A. Gary Anderson Graduate School of Management at the University of California–Riverside; and Shannon W. Anderson of Rice University and Anne M. Lillis of the University of Melbourne, Australia.

The awards were granted in collaboration with the Management Accounting Section of the American Accounting Association.

Also, Kristy Towry, assistant professor of managerial accounting and finance at Emory University's Goizueta Business School, received the Best Early Career Researcher Award from the AICPA.

The award was co-sponsored by the Chartered Institute of Management Accountants in the U.K. and the Society of Management Accountants (CMA Canada) and granted in collaboration with the Management Accounting Section of the American Accounting Association. The $2,000 grant is given to a researcher with the best overall body of research in management accounting, completed within the first five years of joining a faculty.

Mishra and Rolland will study "A Strategic Framework for Internal Control Risk Identification and Analysis." They propose to develop a strategic risk analysis framework that better integrates people, processes and technology in a company's total internal control risk profile.

Anderson and Lillis will study "The Impact of Firm Strategy and Culture on Cost Restructuring." They will extend their current research in Australia to AICPA members to gain data on cost management and restructuring decisions.

Towry's research on the use of accounting information for managerial decision making, with a special focus on managerial control systems and financial incentives, has been in several publications. Her research also examines control systems in a teamwork setting.

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Exposure Drafts Outstanding

(This list was compiled as of Aug. 15, 2008. More current information may be available in *The CPA Letter* or at **www.aicpa.org**. *Note:* The policy for updating the list of exposure drafts is that a document should remain on the list until a final document has been issued or the project has been dropped. However, no comments will be received after the comments deadline has expired. The list is not all-inclusive but is intended to present the exposure drafts of particular interest to professional accountants.)

FASB

Issue Date	Title or Description	Comment Deadline
8/7/08	**Earnings per Share—an amendment of FASB Statement No. 128 (Revision of Exposure Draft Issued September 30, 2005)**	**12/5/08**
6/6/08	Accounting for Hedging Activities (an amendment of FASB Statement No. 133)	8/15/08
6/5/08	Disclosure of Certain Loss Contingencies (an amendment of FASB Statements No. 5 and 141(R))	8/8/08
5/29/08	Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information	9/29/08
10/9/06	Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition (an amendment of FASB Statement No. 142)	1/29/07
10/9/06	Not-for-Profit Organizations: Mergers and Acquisitions	1/29/07
8/11/05	Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140	10/10/05

AcSEC (AICPA)

Issue Date	Title or Description	Comment Deadline
9/12/07	Proposed Audit and Accounting Guide, Airlines	12/15/07

ASB (AICPA)

Issue Date	Title or Description	Comment Deadline
9/2/08	**Interim Financial Information**	**11/3/08**
9/2/08	**Proposed Statement on Auditing Standards, Audit Considerations Relating to an Entity Using a Service Organization**	**11/30/08**
9/2/08	**Proposed Statement on Standards for Attestation Engagements, Reporting on Controls at a Service Organization**	**11/30/08**
6/12/08	Proposed Statement on Auditing Standards, Communicating Internal Control Related Matters Identified in an Audit (Amends AU Section 325, Communicating Internal Control Related Matters Identified in an Audit)	8/12/08
6/12/08	Proposed Statement on Standards for Attestation Engagements, An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements (Supersedes AT Section 501, Reporting on an Entity's Internal Control Over Financial Reporting)	8/12/08
4/30/08	Proposed Statement on Auditing Standards No. 114 (Redrafted), The Auditor's Communication With Those Charged With Governance	6/30/08
4/30/08	Proposed Statement on Auditing Standards No. 103 (Redrafted), Audit Documentation	6/30/08
5/9/05	Proposed Statement on Auditing Standards: Amendment to Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity with Generally Accepted Accounting Principles, for Nongovernmental Entities	6/27/05

OTHER (AICPA)

Issue Date	Title or Description	Comment Deadline
8/13/07	Proposal of Professional Ethics Division, Interpretation on Networks and Network Firms and Proposed Related Definitions	11/13/07
5/15/07	Proposed Interpretation 102-7, Other Considerations: Meeting the Objectives of the Fundamental Principles, and Proposed Framework for Meeting the Objectives of the Fundamental Principles	8/15/07
3/7/01	Statement on Standards for Continuing Professional Education Programs	8/1/01

SEC

Issue Date	Title or Description	Comment Deadline
6/26/02	Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process; Release Nos. 33-8109; 34-46120; 35-27543; IA-2039; IC-25624	9/3/02
5/10/02	Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (Release Nos. 33-8098; 34-45907)	7/19/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 33-8090	6/24/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 34-45742	6/24/02
2/18/00	SEC Concept Release: International Accounting Standards	5/23/00
1/21/00	Supplementary Financial Information	4/17/00

GASB

Issue Date	Title or Description	Comment Deadline
4/4/08	Service Efforts and Accomplishments Reporting—an amendment of GASB Concepts Statement No. 2	7/3/08
2/29/08	Fund Balance Reporting and Governmental Fund Type Definitions	6/30/08

IFAC

Issue Date	Title or Description	Comment Deadline
7/15/08	Code of Ethics for Professional Accountants	10/15/08
6/23/08	Costing to Drive Organizational Performance	9/12/08
6/23/08	Evaluating and Improving Governance in Organizations	9/12/08
3/10/08	Accounting and Financial Reporting for Service Concession Arrangements	8/1/08
3/6/08	Social Benefits: Disclosure of Cash Transfers to Individuals or Households	7/15/08
1/15/08	Proposed Redrafted International Standard on Auditing ISA 210 (Redrafted), Agreeing the Terms of Audit Engagements	4/15/08
1/15/08	Proposed Redrafted International Standard on Auditing ISA 710 (Redrafted), Comparative Information—Corresponding Figures and Comparative Financial Statements	4/15/08
12/21/07	Proposed New International Standard on Assurance Engagements ISAE 3402, Assurance Reports on Controls at a Third Party Service Organization	5/31/08
12/21/07	Proposed New International Standard on Auditing ISA 265, Communicating Deficiencies in Internal Control	4/30/08
12/21/07	Proposed Revised and Redrafted International Standard on Auditing ISA 402 (Revised and Redrafted), Audit Considerations Relating to an Entity Using a Third Party Service Organization	4/30/08
12/21/07	Proposed Redrafted International Standard on Auditing ISA 501 (Redrafted), Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures	3/31/08
12/21/07	Proposed Redrafted International Standards on Auditing ISA 520 (Redrafted), Analytical Procedures	3/31/08
10/15/07	Proposed Revised and Redrafted International Standard on Auditing ISA 505 (Revised and Redrafted), External Confirmations	2/15/08

New additions appear in bold, blue type.

Issue Date	Title or Description	Comment Deadline
10/15/07	Proposed Revised and Redrafted International Standard on Auditing ISA 620 (Revised and Redrafted), Using the Work of an Auditor's Expert	2/15/08
10/1/07	Consultation Paper—Proposed Strategy for 2009–2011	11/30/07
9/5/07	Amendments to IPSAS 4, The Effects of Changes in Foreign Exchange Rates	12/31/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 700 (Redrafted), The Independent Auditor's Report on General Purpose Financial Statements	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 705 (Revised and Redrafted), Modifications to the Opinion in the Independent Auditor's Report	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 706 (Revised and Redrafted), Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 800 (Revised and Redrafted), Special Consideration—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 805 (Revised and Redrafted), Engagements to Report on Summary Financial Statements	11/30/07
7/31/07	Proposed Redrafted International Standard on Auditing ISA 530 (Redrafted), Audit Sampling	10/31/07
5/1/07	ISA 250 (Redrafted), The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements	7/31/07
5/1/07	ISA 200 (Revised and Redrafted), Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance With International Standards on Auditing	9/15/07
5/1/07	ISA 500 (Redrafted), Considering the Relevance and Reliability of Audit Evidence	9/15/07
12/29/06	Proposed Revised Section 290 of the Code of Ethics for Professional Accountants, Independence—Audit and Review Engagements, and Proposed Section 291, Independence—Other Assurance Engagements	4/30/07
12/22/06	Proposed Redrafted International Standard on Auditing ISA 610 (Redrafted), The Auditor's Consideration of the Internal Audit Function	3/31/07
12/1/06	Strategic and Operational Plan, 2007–2009	2/28/07
11/22/06	Proposed Amendment to International Public Sector Accounting Standard, "Financial Reporting Under the Cash Basis of Accounting," "Financial Reporting Under the Cash Basis of Accounting—Disclosure Requirements for Recipients of External Assistance"	3/31/07
11/15/06	Proposed Drafted International Standards on Auditing ISA 320 (Revised and Redrafted), Materiality in Planning and Performing an Audit ISA 450 (Redrafted), Evaluation of Misstatements Identified During the Audit	2/15/07
FASAB		
3/26/08	Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information	6/26/08
8/3/07	Reporting Gains and Losses From Changes in Assumptions and Selecting Discount Rates and Valuation Dates	1/15/08
5/21/07	Accounting for Federal Oil and Gas Resources	1/11/08
10/23/06	Accounting for Social Insurance, Revised (Preliminary Views)	4/16/07
PCAOB		
2/26/08	Proposed Auditing Standard—Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Control Standards	5/12/08
10/17/07	An Audit of Internal Control That Is Integrated With an Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies	12/17/07
5/24/07	Amendments to Limit Board Rule 4003's Fixed Periodic Inspection Requirement to Firms That Regularly Issue Audit Reports	7/23/07
4/3/07	Proposed Auditing Standard—Evaluating Consistency of Financial Statements and Proposed Amendments to Interim Auditing Standards	5/18/07
12/19/06	Amendments to Board Rules Relating to Inspections	2/16/07
5/23/06	Proposed Rules on Succeeding to the Registration Status of a Predecessor Firm	7/24/06
5/23/06	Proposed Rules on Periodic Reporting by Registered Public Accounting Firms	7/24/06
10/26/04	Proposed Rule on Procedures Relating to Subpoena Requests in Disciplinary Proceedings	11/29/04

INFORMATION

The initials stand for the following organizations. Exposure drafts are available online at the Web addresses below or copies may be obtained at the address in parentheses (unless otherwise indicated).

FASB– Financial Accounting Standards Board (Order Department, Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); **www.fasb.org**

GASB– Governmental Accounting Standards Board (Order Department, Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); **www.gasb.org**

AICPA– American Institute of CPAs (American Institute of Certified Public Accountants, 220 Leigh Farm Road, Durham, NC 27707-8110). AICPA publishes exposure drafts exclusively on the Web at **www.aicpa.org**. Print copies are not available.

IASB– International Accounting Standards Board (International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom); **www.iasb.org**

IFAC– International Federation of Accountants (International Federation of Accountants, 545 Fifth Avenue, 14th Floor, New York, NY 10017); **www.ifac.org**

SEC– Securities and Exchange Commission (Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549); **www.sec.gov**

FASAB– Federal Accounting Standards Advisory Board (Federal Accounting Standards Advisory Board, 441 G Street, N.W., Suite 6814, Washington, DC 20548); **www.fasab.gov**

PCAOB– Public Company Accounting Oversight Board (Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, DC 20006-2803); **www.pcaobus.org**

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The Technical Information Service answers inquiries about specific audit or accounting problems. Call toll-free **877-242-7212** or e-mail query to aahotline@aicpa.org. **This service is free to AICPA members.**

New & Noteworthy

Can You Put a Price on Intangibles?

Maybe, if you know about S.L.E.R.T.

By Gary R. Trugman

You should not consider yourself to be a specialist in intangible asset valuation simply because you read a chapter in the new edition of my book, *Understanding Business Valuation*. A specialist requires at least two chapters (and probably more).

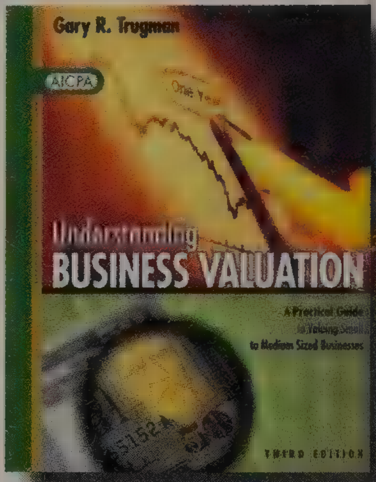
But seriously… This area of valuation is not for everyone. You really need to know what you are doing.

Intangible asset valuation for financial reporting is a dynamic and changing arena with emerging terminology and interaction between U.S. and international accounting standards. If you plan to play in the fair value for financial reporting playground, look for additional classes and specialized work experience.

Increasingly, intangibles—ranging from intellectual property (soon to be defined) and brands to licenses and R&D pipelines—dwarf the tangible book assets of all sorts of companies in all sorts of industries. For example, the market value to book value multiple of the Standard & Poor 500 Index passed the 23 rate in the late 1980s and rose to nearly 53 in 2000, with about a 2.93 multiple from 2002–2007. It is not unusual to see operating companies bought and sold that are in the primary business of owning and managing intangibles, particularly intellectual property. Service companies that are "tangible asset light" see most of their value comprised of intangible assets.

Apart from tangible assets that have financial substance (things like cash, accounts receivable, or prepaid expenses) or physical substance (fixed assets such as equipment), intangible assets show several characteristics:

- **Identifiability.** Intangible assets can be specifically identified with reasonably descriptive names and should see some evidence or manifestation of existence such as a written contract, license, diskette, procedural documentation, or customer list, among others. The intangible assets should have been created at an identifiable time (or event) and be subject to termination at an identified time (or event).
- **Manner of acquisition.** Intangible assets can be purchased or developed internally.
- **Determinate or indeterminate life.** A determinate life will usually be established by law or contract or by economic behavior and should have come into existence at an identifiable time as the result of an identifiable event.
- **Transferability.** Intangible assets may be bought, sold, licensed, or rented and are subject to the rights of private ownership, ensuring a legal basis for transfer.



Understanding Business Valuation
Product # 056604

The two most commonly seen factors of intangibles are identifiable and transferable. Ask yourself if the subject asset will meet the SLERT factors, allowing them to be

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- Exchanged
- Rented
- Transferred

If at least one of the SLERT criteria can be met by an asset lacking substance, chances are that you are dealing with an intangible asset that can be distinguished from the overall goodwill, particularly if the rights to this asset can be separated legally.

Adapted from Understanding Business Valuation, A Practical Guide to Valuing Small and Medium Sized Business, *Third Edition, by Gary R. Trugman published by the AICPA, 2008. To order product #056604, please go to www.cpa2biz.com call toll free 1-888-777-7077.*

New Resources

Publications

Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses, Third Edition

by Gary Trugman, CPA/ABV, MCBA, ASA, MVS

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The International Financial Reporting Standards: An Overview

This informative IFRS overview captures the live presentation given to the AICPA Board of Directors. Arleen Thomas, Senior Vice President, Member Competency and Development, AICPA; Bob Laux, Senior Director, Technical Accounting and Reporting, Microsoft Corporation; and Danita Ostling, Partner, Ernst & Young's Professional Practice Department, join for a lively discussion. Choose the new On-Demand format for immediate online access.

Recommended CPE credit: 2
Level: Basic
Prerequisite: None
Format: CD-ROM (739750hs) or On-Demand (157220)
$65.00 member/$81.25 nonmember

Best Sellers

Accountant's Business Manual Online,
No. ABM-XX
$159.00 member/$198.75 nonmember
Looseleaf, 2 vols, No. 029418
$170.00 member/$212.50 nonmember

Audits of Banks, Savings Institutions, Credit Unions and Other Financial Institutions
No. 733440
Recommended CPE Credit: 8
Level: Intermediate
Format: Text. $145.00 member/$181.25 nonmember

Buying and Selling Businesses: The CPA's Role
Text, No. 733750; DVD/Manual, No. 183750
Recommended CPE Credit: Text, 14; DVD/Manual, 16
Level: Intermediate
Text, $155.00 member/$193.75 nonmember; DVD/Manual, $205.00/$256.25

Not-for-Profit Organizations Accounting Issues and Risks 2008: Strengthening Financial Management and Reporting—Financial Reporting Alert
No. 029207
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CPE Direct
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Recommended CPE credit: Up to 48 per year
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State and Local Government Strategic Briefing, 2008-2009
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No. 012538
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Web Events

- **Malpractice Risks: Navigating the New Frontier**
  Thursday, October 23, 2008
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- **Revised Peer Review Standards**
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Accountant (Bronx, New York) – Bachelors of Science plus 2 years experience in student financial aid and IRS regulations using Datatel software. **Respond to Monroe College, accountantjob@monroecollege.edu.**

Accountant – Journalize daily transactions. Bank reconciliation. Communicate with office in China to ensure all vendors are paid in a timely manner. Crosscheck invoices with China office. Requirements: BS-Accounting, plus 1 year experience including accounting transactions, managing balances and cash flow, account receivables, reconciliation of bank statements, and payroll. Chinese fluency. Resumes: **Attention: Kari, Global X Trading, Inc., 252 W. 37th St, 10th fl., New York, NY 10018. Reference: HLC2008.**

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Washington Positions: We are currently seeking accounting professionals, with at least four years of public accounting (preferably with a large national firm) or banking experience to complement our Chief Accountant's Office staff. Major responsibilities include researching and formulating accounting policy and reporting standards for national banks, interpreting accounting principles, and identifying solutions to complex accounting issues.

Responsibilities also include coordinating policy development with staffs of the accounting standard-setters, including the Financial Accounting Standards Board and Securities and Exchange Commission, and representatives of other regulatory agencies, as appropriate. The Senior Policy Accountants will also participate in the development of international supervisory guidance through the OCC's representation on the Basel Committee on Banking Supervision and its related working groups.

New York City Position: Situated in NYC, this role is a vital component of OCC's Office of the Chief Accountant. The person we seek is a Senior Accounting Professional who can effectively research and respond to accounting questions raised by OCC personnel, bankers, public accountants and other regulatory agencies. In this role, you will also represent the Office of the Chief Accountant in activities and meetings with external bankers and CPAs. In addition, you will investigate and interpret the effects of industry developments and emerging accounting issues and their impact on national banks.

To be successful in either of these positions, you possess CPA qualifications and have experience interpreting and resolving multifaceted bank accounting issues. When required, you can skillfully present complex accounting issues and policies both in writing and orally. In fact, you articulate substantive issues clearly and concisely and present ideas and information in a logical and persuasive manner. You display exceptional foresight in identifying problems, and your decisions are highly regarded and accepted by peers, managers and colleagues.

For a detailed announcement, please visit our website: **www.occ.treas.gov** to learn more about the OCC and how to apply for Careers at the OCC. You can also visit: **www.usajobs.gov** to apply towards vacancy announcements DEU-TM-08-028 and DEU-TM-08-061. For further information, please contact **Tracey Mcilwain at (202) 874-4915.**

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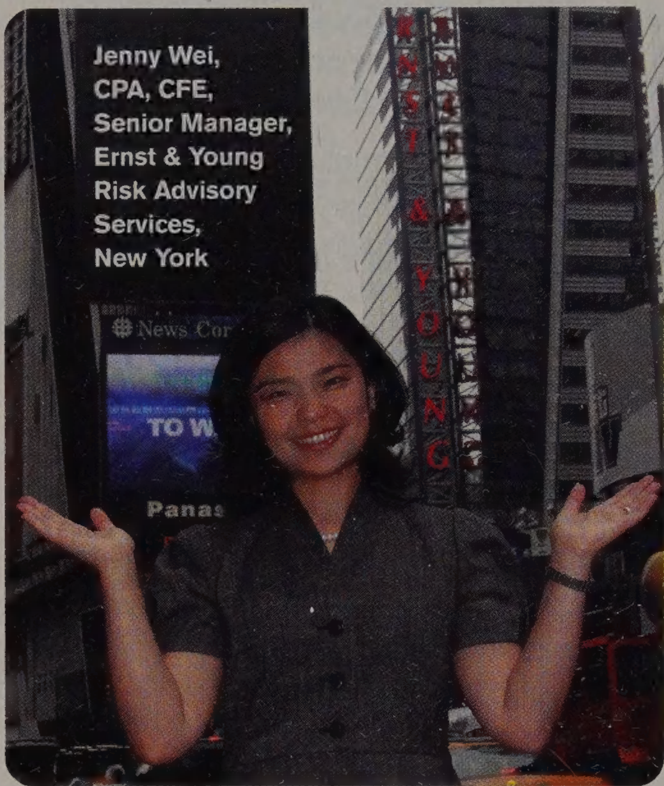
THE LAST WORD

I currently serve as the president of the Chinese American Society of CPAs. I also serve as the national vice president of student affairs for Ascend (formerly known as the National Asian American Society of Accountants). We launched Ascend in 2005. Our vision is to enhance the presence and influence of Asians and Pacific Islanders in finance and accounting. Within three and a half years we've grown to over 4,000 members. We have 22 professional and student chapters across the U.S., and our members represent over 150 companies.



Jenny Wei, CPA, CFE, Senior Manager, Ernst & Young Risk Advisory Services, New York

Ascend offers various mentorship programs. Mentors are accomplished senior Asian-American financial executives, CEOs, entrepreneurs and professional services providers. These programs are generally delivered at the locations of the mentors, providing the mentees an opportunity to showcase their companies and also providing an opportunity for their personnel to interact with the mentees. Ascend also offers a mentoring program where college students are matched with young professionals. Students will learn and gain valuable insights into the unspoken subtleties of doing business in the accounting and finance fields. The term of the mentoring relationship is designed to be one school year. However, the mentor and mentee may maintain the relationships at their discretion.

I personally have benefited greatly from having many mentors in my career. Mentoring is one of the most crucial and important factors in career success. I would like to give back and develop our future leaders and help them succeed. At Ascend's inaugural annual National Convention in August, I was approached by students and young professionals seeking a mentor. I feel honored and privileged because I will have the opportunity to work with a new generation of leaders and provide guidance in their career decisions. I believe many mentoring relationships will lead to lifetime relationships.

I was born and raised in Taiwan, and when I was young, I was told that I should try to get into one of the three professions: medicine, law or accounting. And personally I don't like blood, so that made it two choices. I decided to take my first accounting class in my high school senior year and was able to quickly understand the accounting principles. The class reassured my determination on becoming a certified public accountant. And then, when I came to the United States (I was 17), I majored in accounting at Cal Poly Pomona.

I wanted to get hands-on experience when I was going to school at Cal Poly Pomona. So I looked in the Yellow Pages and called all the accounting firms. "I want to work between my home and school—part time," I said. That's how I got my first part-time job with a local public accounting firm. The firm had two partners, and they both came from Big Eight firms. I built a solid foundation as a staff accountant by working there for three and a half years. And then I got an offer from the regional firm Moore Stephens Wurth Frazer and Torbet, a member of Moore Stephens International, an accounting firm association.

There was a big market out there that we had not explored. Geographically, Moore Stephens Wurth Frazer and Torbet was located in City of Industry, Calif., and 60% of companies were Chinese- or Asian-owned. So I went to the managing partner, shared with him my desire to develop this Asian client base and he agreed. Within three months we got our first Asian-owned audit client. Asian Services became one of the largest practice areas within the firm.

I have worked in Ernst & Young's Risk Advisory Services for over seven years. I enjoy what I do and am able to balance my career with my personal life with support from the people I work with. I am afforded the opportunity to work from home and prioritize my professional commitments as well as my personal commitments.

I would definitely encourage any young person to join the accounting profession. There are so many opportunities. You need to know what you want, set your career goals and plans, and give your best.

—As told to Matthew G. Lamoreaux

PHOTO BY DENNIS MILBAUER